The Tax Regime of Interest On Government Bonds

The following document is aimed at illustrating the fiscal regime on interest and other revenues arising from Government bonds; it does not substitute for, nor does it integrate in any way, the ministerial decrees or the circulars issued by the Revenue Department of the Ministry of Economy and Finance, which must serve as a point of reference in general, and especially for the resolution of specific issues.

Normative Sources

The main normative text regulating the tax regime of interest on Government bonds is the legislative decree 1st April 1996 no.239 (leg. decree 239/96), subject to amendments and subsequent supplements.

The original legislative text was in particular revised by the decree-law 20th June 1996 no. 323, turned into, with modifications, the law 8th August 1996, no. 425; by the legislative decree 21st November 1997, no. 461; by the legislative decree 16th June 1998, no. 20; by the legislative decree 21st July 1999, no. 259; by the legislative decree 23rd December 1999, no. 505; by the decree-law 25th September 2001, no.350, turned into, with modifications, the law 23rd November 2001, no. 409; by the decree-law 22nd February 2002, no. 12, turned into law 23rd April 2002, no. 73; finally, by the decree-law 30th September 2003, no. 269, turned into, with modifications, the law 24th November 2003, no. 326.

Context of application

The provisions mentioned above and described in the following paragraphs are applicable to any kind of Government bonds (BOT, CTZ, CCT, BTP), independent of dates of issue and maturity.

Summary of the tax regime

The present tax regime of interest on Government bonds provides:

1. the contribution to the determination of the tax base, subject to income taxes (and, where due, to the regional tax on business activities) for interest gained within the activity of business firms; and
2. the application of a 12.5% lieu tax on interest gained outside a business firm (this is the only tax to which said interest is subject).

Accordingly, for all resident taxpayers that are not physical persons and that are earning interest on Government bonds running a business activity, the interest is not subject to any tax at source or substitutive withdrawal and contributes, together with the profit and loss elements of income, to the determination of the total taxable income.

For all other resident subjects, tax is collected in the form of a lieu tax by the financial brokers, at a fixed rate of 12.5%. The application of this lieu tax exhausts integrally the fiscal duties of taxpayers subject to it, with the only exception of interest and other profits earned by physical persons in the running of a business activity. In this last case all profits are included in the business income and the lieu tax is subtracted from the income taxes due on said profits.

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1 This is typically the case for interest gained by joint-stock companies resident in Italy, by limited partnerships and by unlimited partnerships resident in Italy and by permanent branches in Italy of companies resident abroad.
Lastly, it should be remembered that article 41 of decree-law 269/03, turned into, with modifications, the law 24th November 2003, no. 326 established the repeal, for income earned as of 1st January 2004, of the equalizer for all bonds without coupons. For information on the application of the regulation, see circular no. 61-E of December 31, 2003, issued by the Agenzia delle Entrate (Italian Revenue Agency), available at the website: www.publicdebt.it in the section on "Tax Regime" for the "Treasury Securities" category, ("Explanatory Note" page).

**Resident taxpayers subject to lieu tax**

Taxpayers resident in Italy, liable for lieu tax, are:

a) natural persons;
b) simple companies or professional associations;
c) non-commercial bodies;
d) subjects exempt from income tax on legal persons.

**Income subject to lieu tax**

Lieu tax applies to coupon interest and to the difference between the issue price below par (100) and the reimbursement value. Obviously, for every taxpayer lieu tax is applicable in relation to interest matured in the period during which the bond was held.

Note that in the case of reopening of subscriptions for bonds issued in various tranches, the issue price is considered to be the auction price of the first tranche of the loan.

For BOTs and CTZs, bonds without coupons, interest is represented by the aforementioned difference, to which lieu tax is applied.

**Modalities for lieu tax application**

Lieu tax is applied by banks, by financial brokers (SIM), by trust companies, by stockbrokers and by other subjects specifically indicated in the relative MEF decrees, who are residents in Italy and who intervene in interest collection or, as purchasers, in the transfer of Government bonds, at any stage.

It must be noted that, in order to apply lieu tax, we consider transfer of Government bonds to be the following:

a) assignments;
b) any act, in payment or as a gift, which implies the change of the legal possession of the bond;
c) transfers to any other deposit or account held by the same or different brokers;
d) drawings from deposits held by the brokers (these drawings must be regarded as subject to taxes if related to bonds issued abroad as of the 10th of September 1992, as per art. 31 of the Decree of the President of the Republic 29th September 1973, no. 601).

**Special regime for undertakings for collective investment in transferable securities (UCITS) resident in Italy and for the individual asset management companies**

Interest (and capital gains and losses) accrued in undertakings for collective investment in transferable securities (UCITS) resident in Italy are not subject to the lieu tax mentioned above. For these subjects, in fact, the tax rate of 12.5% or in certain cases, of 5% is calculated on the activity result.

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2 Mutual open securities investment funds and variable capital companies (SICAV – Open-ended investment company).
accrued every year. This result is calculated subtracting from the value of the net capital at the end of the year, increased by the refunds and proceeds distributed, the value of the net capital at the beginning of the year increased by the subscriptions.

To calculate the value of the capital, we include interest accrued and not collected, and capital gains and losses accrued by the end of the year on the bonds held.

The same regime is applied to the interest (and capital gains and losses) accrued by individual asset management companies of those same taxpayers otherwise liable for the 12.5% lieu tax in agreement with the legislative decree 239/96.

In the case of undertakings for collective investment in transferable securities (UCITS) whose shares or stocks are subscribed exclusively by subjects resident in countries that allow an adequate exchange of information (the so-called "white list" approved with Ministerial Decree 4 September 1996 and subsequent amendments), these same are exempt from the lieu tax on the operating income that otherwise would have been of 12.5% and 5%.

In these cases, non residents must submit, upon subscription or purchase of shares or stocks, either a declaration of residence (valid for one year) issued by the fiscal authorities of the country of residence or the self-certification form, described in the paragraph, "Procedure for the application of exemption for non-residents".

Lastly, non-resident subjects who earned income from undertakings for collective investment in transferable securities (UCITS) subject to lieu tax, reserve the right, upon request to the company managing mutual fund, to the SICAV (Open-ended investment company), or to the party entrusted with the placement of the shares or stocks no later than December 31 of the year in which the income is earned, to pay an amount equal to the 15% of the income earned, as refund of the lieu tax of 12.5% paid by the UCITS. In the event that the UCITS is specialized in buying shares or stocks of quoted companies of small and medium capitalization and it has paid the lieu tax of 5%, the non-resident subscribers reserve the right to be paid, as a refund, an amount equal to 6% of the aforementioned income.3

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**Real estate funds**

Interest (as well as capital gains and capital losses) earned on Italian real estate funds is not subject to lieu tax.4 These funds are not subject to income tax or to the Regional Tax on Productive Activities (IRAP).

Income distributed by the real estate fund are subject to a withholding of 12.5%. The withholding is applied as an advance tax payment on income earned in the running of a business firm by resident taxpayers and it is a sole tax in all other cases.

The withholding is not applied, however, to income paid to subjects resident in countries that allow an adequate exchange of information (the so-called "white list" approved by M.D. 4 September 1996 and subsequent amendments).5

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3 In accordance with Legislative decree 21 November 1997, n. 461, article 9, paragraphs from 1 to 3; See also the Circular of the Agenzia delle Entrate (Italian Revenue Agency) n. 60/E of 31 December 2003.


5 Inclusion in the "white list" is based on art. 6, paragraph 1, of the legislative decree 239/96, which establishes the non-application of the lieu tax for subjects resident in countries that allow for an adequate exchange of information.
Pension funds

Interest (as well as capital gains and capital losses) earned on pension funds is not subject to lieu tax but is included in the operating income of the fund which is subject to the lieu tax with a rate of 11%.  

Special regime for non-resident holders

Interests on Government bonds issued in Italy are not liable for any tax if their holders are resident in countries which allow an adequate exchange of information (so called "white list", approved by Ministerial Decree 4 September 1996 and further amendments).

It is possible to check the "white list" on the Internet site of the Agenzia delle Entrate (Italian Revenue Agency), www.agenziaentrate.it.

In the event the above requisites are not met, the taxpayers living abroad who gain interest on Government bonds are liable for the 12.5% lieu tax unless this interest is collected by a permanent organization in Italy. In this case, interest accrued contributes to determine income subject to personal taxes.

Moreover, interest is tax exempt whose holders are:

- bodies and other international entities set up according to international agreements implemented in Italy;
- foreign institution investors, even if not given any fiscal status as a subject, set up in countries where the exchange of information is allowed;
- Central Banks or other institutions in charge of managing government official reserves.

Procedure for the application of the exemption for some non-residents

In order to obtain the exemption, non-resident subjects must deposit the bonds, directly or indirectly, at:

a) a bank or a financial broker resident in Italy; or
b) a permanent organization of a bank or a non-resident financial broker which has direct electronic links with the Ministry of Economy and Finance; or
c) a body or a non-resident company maintaining accounts with centralized clearance systems and which has direct electronic links with the Ministry of Economy and Finance.

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6 This refers to pension funds whose fiscal regime is currently regulated by articles from 14 to 14 quarter of the legislative decree of 21 April 1993, n. 124.
7 It should be recalled that interest on Government Bonds issued abroad is not subject to any Italian tax if earned by non-resident subjects.
8 See note 5.
9 See the Circular of the Agenzia delle Entrate (Italian Revenue Agency) no. 20/E of 27 march 2003 available at the website: www.publicdebt.it in the section on "Tax Regime" for the "Treasury Securities" category ("Explanatory Note" page).
Moreover, non-resident subjects must provide the company or body depository of securities, with:

1. a certification which demonstrates the existence of the qualifications to enjoy the convention against the double taxation;\(^{10}\)
2. information about the non-resident subject beneficiary of the bond proceeds.

The above procedure is not necessary for the following bondholders:

a) bodies or other international entities set up according to international agreement implemented in Italy; and
b) Central banks or other subjects who are also engaged in activities of the Government official reserve management.

**Taxation of the capital gains on Government bonds**

As for interest, also for capital gains taxpayers can be divided into two broad categories:

1. taxpayers who realize capital gains or losses in their business activity; and
2. all other taxpayers.

Capital gains (and losses) referred to the subjects belonging to the first category contribute, together with the profit and loss elements of the income, to the determination of the total taxable income.

Resident taxpayers, different from those included in the first category, are liable for a 12.5% lieu tax on the algebraic sum of capital gains and losses from the bond (and from the share holdings which are not defined relevant by the law) realized during the tax period.

Capital gains on Government bonds earned by non-residents are tax-exempt in Italy.

The amount of capital gains (or losses) is constituted by the difference between the dismissals price, net of income matured but not collected during the period of ownership of the bond, and the purchase price, also net of income matured but not collected since the date of purchase.

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Capital gains (or losses) on Government bonds must be algebraically summed with the other capital gains and losses accrued during the tax period (provided that they are subject to the 12.5% lieu tax). If capital losses are less than capital gains, the surplus is deducted from the capital gains of the next tax period, but not after the fourth one, providing that capital losses are reported in the tax return of the tax period in which capital losses are realized.

\(^{10}\) It should be noted that until the approval of a new self-certification form scheme, non-resident subjects can continue to use the self-certification form, approved by Decree of the Ministry of Economy and Finance of 12 December 2001, available on the web site: [www.publicdebt.it](http://www.publicdebt.it) in the section on "Tax Regime" for the "Treasury Securities" category and on the web site of the Agenzia delle Entrate (Italian Revenue Agency) [http://www.agenziaentrate.it](http://www.agenziaentrate.it)
**Managed and administrative saving regime and declared regime**

Natural persons and all other taxpayers different from business firms who gave individual asset management mandates to subjects qualified according to the legislative decree of 23rd July 1996, no. 415 (banks, Securities Dealing Firms, brokerage companies, etc.) can choose the tax application on the activity result. The taxation regime deriving from the previous option is acknowledged as the "**managed saving**" regime. The activity result includes both interest accrued from Government bonds during the activity period, and capital gains accrued in the same period from the same bonds. The tax due on the accrued management result is 12.5%.

Alternatively, the same subjects who hold bonds in the custody or administration of banks, Securities Dealing Firms, and other subjects indicated in ad hoc ministerial decrees can choose the application of the 12.5% lieu tax on every capital gain deriving from the bonds in custody or administration. This regime, acknowledged as the "**administrative saving**", is not applicable to interest on Government bonds to which there is applied — by brokers — a 12.5% lieu tax, but only to capital gains on the aforementioned bonds.¹¹

Finally, the same subjects can choose the "**declared regime**" according to which the 12.5% lieu tax will continue to be applied to interest by brokers. Capital gains accrued on Government bonds, on the contrary, must be indicated in the annual tax declaration, the tax still being 12.5%.

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¹¹ It is worth noting that the "default" regime for capital gains, available for non-resident subjects, is the administrative savings one, although it is possible for the taxpayer to renounce this regime.