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ITALY

Italy's highest court allows for rebate of property tax to commercial tenants

An important jurisprudential precedent was set in Italy last year that provides a degree of certainty around controversial clauses in lease agreements whose compatibility with the national legal system was called into question.

An Italian Supreme Court decision in Unified Sections dated March 8, 2019 (no. 6882) stated as lawful a clause in commercial lease agreements that allows a landlord to rebate the property tax (IMU) due on a property to the tenant. This marked an important step towards the possibility of entering into lease contracts that are increasingly in line with the so-called "triple net" standard, widely used in international commercial practice.

The case An international operator of retail premises, tenant of a supermarket site (assumed in the context of a sale and leaseback transaction), acted to obtain the declaration of nullity of a clause of the lease contract it had entered into with the landlord. This clause provided that during the entire duration of the lease agreement, the tenant would take charge of any tax and duty related to the property.

Under Italian tax law, the IMU property tax is due from the landlord of real estate, regardless of the fact that the property is leased to a third party. IMU is not payable by a tenant, who does not have the ownership of the property.

Consequently, the tenant had asked the judges to declare the nullity of such a clause, referencing the contribution principle set out in Italy's Constitution, with the general prohibition of transfer of tax charges to other persons, and provisions related to lease agreements (residential and non-residential) that expressly list charges that can be recharged to the tenants. This was in accordance with the principle that, further to the rent, the landlord may charge to the tenant only the pure expenses paid for "common services" provided to the leased premises.

The Supreme Court decision

The Unified Sections summarized the question of law: "Whether the constitutionally relevant obligation to contribute to public expenditure on the basis of its own contribution capacity has an exclusively 'objective meaning' – in the sense of obligation to fulfil on the basis of what the contribution capacity allows – or even subjective – in the sense that the fulfilment must be accomplished not only for the due amount, but also by the person who has the obligation under the law – thus excluding the possibility to transfer the obligation to a different subject."

In other words, the issue is whether the negotiating autonomy can affect the identification of the person liable for tax, neutralizing the effects of the principle of contribution capacity. The answer given is affirmative and gained from two earlier decisions by the Unified Sections dating back to 1985, which reached almost opposite conclusions.

The first decision considered as prohibited and therefore null the agreement with which a subject, even without affecting the obligations vis-à-vis the tax authorities, had actually transferred the burden of its own taxation to another, at least in terms of direct taxes.

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The second decision instead affirmed the nullity of the translation agreement exclusively to the case in which the taxes were not actually paid to the tax authorities by the liable subject, so to exclude the nullity of these kind of agreements in the event that they have the function of integrating the "price" of the negotiation service.

Based on the latter decision, which was reiterated several times in the subsequent case law, the Supreme Court came to consolidate the lightest jurisprudential orientation, (re)affirming the principle of law according to which "any agreement on the translation of taxes is contrary to public order only when it implies that the tax is not actually paid to the Tax Authorities by the liable entity".

The private autonomy, therefore, cannot provide for exemptions from liability with effect towards the tax authorities. In other words, the landlord remains the only entity liable vis-à-vis the tax authorities, even if the parties privately agree to translate the tax burden from the landlord to the tenant.

Regarding the most recent decision, the Unified Sections – even if not 100% clear – seems to recognize the amount due under the clause contained in the lease agreement mentioned above as an additional item of the rental fees, and contributes to determining the overall economic burden incurred by the tenant. The transfer agreement of the IMU to tenant, being related to the determination of the amount of rent, is not subject to the binding legislation and furthermore, in the case at hand, the will of the parties to enter into such specific agreement clearly emerged from the reconstruction of the negotiations between the parties. In particular, the lease agreement under judgement, as mentioned above, was a "B2B" agreement, entered into among companies of primary standing (i.e. a professional real estate investor, as buyer-landlord, and an international retail chain, as seller-tenant) in the context of a large-scale sale and leaseback transaction, involving a number of buildings used as supermarkets, all leased on the basis of a common lease template.

Conclusions and implications

From a legal and tax perspective, the following points are worth considering.

It is important to underline that, in Italy, the main laws related to lease agreements – i.e. July, 27 1978 no. 392, as amended, for commercial lease agreements and December, 9 1998 no. 431, for residential lease agreements – provide significant protections for tenants. Certain amendments and liberalizations were introduced in 2014, with reference to commercial lease agreements having an annual rent higher than EUR250,000 to encourage free negotiation between the parties.

It's also worth noting that the Supreme Court decision is related to a commercial lease agreement entered into before the amendments to the Law 392/1978. Therefore, it could be argued that the provision aimed at allowing the translation of the IMU burden on the tenant is generally practicable, also in those lease agreements which have been signed before the 2014 liberalization, provided that the integration of the rental fee has been originally agreed between the parties.

In addition, the Unified Sections do not take a clear position on how recharging of the IMU from lessor to tenant should be treated from a VAT perspective. This would depend on how the IMU rebate should be considered from a legal perspective. If the transfer of the IMU burden was defined as a pure IMU rebate, the transfer would be considered as a sort of "mandate without representation" of the tenant to the landlord to pay IMU, so that the landlord would pay IMU in its name but on behalf of the tenant. This, however, would be in contrast with the IMU law, which provides that the entity liable to tax is indeed the owner of the real estate property and not the tenants.

Consequently, it would be more appropriate to treat IMU as a component of the rental fee, in particular a sort of "variable rental fee", and as such subject to the ordinary VAT treatment (22% VAT rate applied at the option of the landlord) and to the proportional registration tax due on lease agreement (1% or 2% of the yearly rent, as the case may be).

In any case, this seems to be the solution adopted in the case under scrutiny by the Unified Sections, and it will be left to the competent tax authorities to verify the correctness of such a tax treatment. An official position of the tax authorities has not been published, and it is easy to predict the issue could become a hot topic in the future. It is certain that a ruling request before entering into an agreement with such clauses would be advisable.

Finally, it is important to highlight that, even if the Supreme Court ruling has been issued with reference to a commercial lease agreement, an application of the translation rule to residential lease agreements (at least, to those residential leases with freely negotiable rental fees, which are the majority) cannot be excluded. The important aspect to consider in the residential field, in case the landlord is an investor (or in any case an entity different from a natural person) is the possibility for the same landlord to be in the position to demonstrate – in case of disputes – that the meaning and economic impact of the translation clause was fairly negotiated among the parties and understood by the tenant.

Such a conclusion, which needs to be tested in the market, could represent a powerful incentive to the growing serviced apartments/ enhanced living industry, where the tax costs of housing leases –mainly given by the impact of VAT, not recoverable by the real estate operator – could be partially off-set by transfer of IMU to the final tenants.

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