Italian Revenue Agency endorses the OECD's principles on the taxation of stock option benefits under tax treaties

In its recent Ruling No. 316/2020, the Revenue Agency has explicitly endorsed the principles laid down in the Commentary on Article 15 of the OECD Model Tax Convention with regard to the taxation of stock option benefits (see also Circular Letter No. 17/E of 2017 and Ruling No. 78/2020).

The case concerned an individual that had been working for the Italian subsidiary of a MNE between 2003 and 2016. In 2010 he received certain stock options, which he could exercise after a 3-year vesting period. After the date of vesting, he moved to Switzerland to work for another company of the MNE, where he later exercised the options while being a Swiss tax resident.

The Revenue Agency correctly: (i) characterized the income derived from the exercise of the stock options as employment income under Italian tax law; (ii) regarded that income as sourced in Italy under domestic sourcing rules; (iii) concluded that Italy also maintained the primary taxing right over that income, as source State, under Article 15 of the Italy-Switzerland tax treaty (following the OECD Model). With regard to (iii) the Revenue Agency maintained that the stock option benefits should be regarded as linked to the employment activities performed in Italy during the vesting period, for which Article 15(1) and (2) allow taxation in the State where the activities are performed without any time limitation (see also para. 12.1 of the OECD Commentary on Article 15).

It is worth recalling that the OECD Commentary on Article 15, which is explicitly referred to by the Revenue Agency, endorses two main principles: (i) as a general rule, an employee stock-option should be considered to relate to the services rendered during – and not after – the vesting period (paras. 12.7-12.8); (ii) an employee stock-option should only be considered to relate to services rendered before the time when it is granted to the extent that such grant is clearly intended to reward the provision of such services by the recipient for a specific period (para. 12.11). Finally, according to the Commentary, although the determination of whether and to what extent an employee stock-option is derived from employment exercised in a particular State should be carried out on the basis of all the relevant facts and circumstances (para. 12.6), in cases of doubts it should be recognised that employee stock-options are generally provided as an incentive to future performance or as a way to retain valuable employees, so that they are primarily related to the future services rendered during the vesting period (para. 12.13). Based on the facts sketched in the Ruling – given that the individual had carried out his employment activities in Italy during the vesting period and that there was no evidence that the stock options were intended to reward past services rendered by the employee – it appears that the Revenue Agency correctly applied the principles encompassed in the OECD Commentary to the case at stake.

The Ruling indirectly confirms the view that, in the reverse case of an individual who has transferred his tax residence in Italy and opted for the lump-sum tax regime provided for under Article 24-bis of the Income tax code (Euro 100,000 substitute tax for – almost – all foreign source income), the income stemming from the exercise of a stock option for which the employment activity has been carried out abroad during the vesting period should be generally regarded as foreign source income covered by the Euro 100,000 substitute tax (see, to a similar extent, Ruling No. 78/2020).

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