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ITALY: New Tax Guidelines on Trust and Taxation

Circular Letter no.34/E/2022 by the Italian Tax Authorities

November 2022

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INTRODUCTION

With Circular Newsletter No. 34/E the Italian Revenue Agency provides the long-awaited **official guidelines about trust and taxation in Italy**, setting some milestones on direct and indirect taxation, as well as on tax monitoring obligations with interesting positions applicable to **International and cross border wealth and trust structuring**.

The Circular seems to reflect many of the instances of professionals who, including our firm, have contributed to the tax dialogue on the subject after the initial official draft was published on August 11th, 2011. Indeed, the Agency must be credited with a strong focus on making their interpretation clear, thus contributing to improve the dialogue with taxpayers and making these ductile tools even more attractive for clients, both with a domestic or International setting.

This document is aimed to summarise the main issues pointed out within the 65 pages of Circular no. 34/E from a cross-border stand point.

INCOME TAXATION

Non-resident trusts

From 2007, trusts are taxable entities in Italy (art. 73 of the Italian Consolidated Tax Act– D.P.R. n. 917/1986 ("ITCA")) and subject to IRES (corporation tax).

On this regard has been clarified that **non-resident trust are liable to tax on a source-based principle**.

As known, according to Italian rules a trust can be classified as **opaque** (taxes are upon the trust itself) or **transparent** (taxes are imputated directly to income beneficiaries).

Exceptions to the "Italian source" base arises with reference to:

A. Income produced by **non-resident "transparent" trust** with Italian tax resident beneficiaries; or

B. Income distributed by **non-resident opaque trust "established" in low-tax jurisdictions** to Italian tax resident beneficiaries.

Non-resident "transparent" trust

More in details, Italian Tax Authorities clarifies that income produced by ***non-resident transparent trust*** are taxed upon the Italian tax resident beneficiaries regardless income is sourced in Italy or abroad.

To qualify the **beneficiary as "income vested"**, under the view of Circular Letter no.34 the beneficiary has to be punctually "*identified*"and to be **entitled to claim from the trustee the distribution of a given income produced by the trust**. On this regard, Italian Tax Authorities has definetively clarified that – in the case of individual beneficiary – the income is taxed upon the beneficiary regardless of any actual distribution and at progressive income tax rate. At the time of the actual distribution, no further taxes are due by the beneficiary.

Trust "established" in low-tax jurisdictions

As far as the second exception is concerned, it has been clarified that if the opaque trust is **'established'** in low-tax jurisdictions, the "*distributions*" of income by the trust to the beneficiary (therefore even if not "income *vested*") are subject to progressive taxation in the hands of the same beneficiary as **capital income on a cash-basis**.

In this case, in fact, the reduced taxation in the hands of the foreign trust corresponds, in any case, to the taxation in the hands of the resident beneficiary for the allocations by the trust.

Moreover, **low-tax jurisdictions** are classified with exclusive reference to the treatment of income generated by the resident trust. Thus, the element that is taken into consideration is **the tax residence of the trust for income purposes**.

Specifically, **are "low-tax jurisdictions" the States and territories, in respect to which the income produced therein, integrates a nominal level of taxation lower than half of the level of taxation applicable in Italy**. Special tax regimes applicable to the foreign trust shall also be taken into consideration to verify the nominal level of taxation. Therefore: as the nominal corporate tax rate ("Ires") in Italy is 24%, any trust on which income is taxed at less than 12% is to be classified as being from a "low-tax" jurisdiction for Italian tax purposes

As per **the term "established"**, it must in general refer to the jurisdiction of residence of the trust, according to its rules, as resulting at the time of the 'attribution' to the resident beneficiary. This, on condition that the distributed income was taxed in the hands of the trust,

at the time of production, in accordance with the minimum level of taxation.

Tax residence of trust is therefore of utmost importance, also in order to verify whether or not is is to be classified as "low-tax" for Italian purposes.

Where the criterion used therein is that of the **place of administration** and the trust is deemed to be resident for tax purposes in the country where the trustee is resident for tax purposes, in the presence of two co-trustees, one of whom is resident in a EU State and the other established in a low-tax country, the tax-residence of the Trust will be in the State where the trust is actually taxed.

Similar considerations must be made where the criterion used is that of the **main object**. This criterion is closely linked to the type of trust. If the object of the trust is real estate located entirely in Italy, the identification of residence is easy; if, on the other hand, the real estate is in many countries, reference must be made to the prevalence criterion.

In the case of movable or mixed assets, the object must be identified with the **actual and concrete activity exercised**, the residence of the trustee or of the beneficiaries being irrelevant for this purpose.

Where the trust is not considered to be tax resident in a State (due to the particular technical operation in a jurisdiction or due to a specific exemption, whether conventional or not), but has its seat of administration in that State, it must nevertheless be considered to be established there.

The Circular letter is pretty accurate in clarifying the **concept of Capital and of Income, within the context of Italian tax rules**.

In the case of distributions from trust "established" in low-tax jurisdictions, where it is not possible to distinguish between income and capital, the entire amount attributed - pursuant to the presumption set forth in the Italian Tax Law - constitutes income.

The Trustee is therefore required, in order to avoid this presumption, to keep adequate analytical accounts, according to the tax rules applicable in Italy, aimed at distinguishing the components of:

- **Income,** consisting of any income earned by the trust, including any reinvested or capitalised income;
- **Capital**, consisting of the initial dispositions and any subsequent transfers made by the settlor or third parties in favour of the trust.

Non-resident beneficiaries

Non-resident beneficiaries of a resident Opaque Trust

Generally speaking **non-resident beneficiaries of an Italian resident opaque non-commercial trust** (or trust without "income vested" beneficiaries not carrying out a business activity) are not liable to tax upon the income distribution received.

Clarifications made by the Italian Tax Authorities with regard to **Opaque Commercial Trust** (i.e. Trust carrying out a business acitvity), on the contrary, may have a relevant impact to the tax treatment of non-resident beneficiaries.

More in details, the income produced by an Opaque Commercial Trust is basically treated as income produced by a company. On this regard, the Italian Tax Authorities clarifies that the actual distribution of income to the beneciary should be taxed as dividend at 26% substitute tax rate.

Although not expressly clarified by the Circular, a coherent interpretation may lead to suggest that also in the case of distributions made by a opaque commercial resident trust, this latter should whithold a 26% substitute tax. Serious and careful consideration must be given to the possibility of applying the benefits of the potential applicable **double taxation treaties** (if existings).

Non-resident beneficiaries of an resident "Transparent" Trust

The Circular does not address in deep the tax treatment of **non-resident beneficiaries of a resident transparent trust**. More in details, on this point, has not been clarified whether the **income "imputed"** to the beneficiary should be in any case considered as sourced in Italy (as previously expressed by the Italian Tax Authorities in remote Circular Letter no. 61 of 2010).

INDIRECT TAXATION

The Overcome of the "entry-taxation" position

The Italian Tax Authorities definitively confirm the overcome of the so-called "entry-taxation" positions, according to which the Italian Inheritance and Gift taxes (hereinafter also "IHT") was due at the time of the asset transfer to the Trust Fund. By acknowledging the position of the Italian Supreme Court in the last years, as already commented in our previous alerts, **the Italian Tax Authorities states the principle that the transfer made by the Settlor to the Trust is not relevant**

for IHT or Gift Tax in so far as a "stable and effective" enrichment of the beneficiary occurs.

The transfer of assets by the Settlor to the Trust is only subject to €200 Registration tax in only due, plus €50 cadastral and mortgage tax each in case of real estate disposal.

The "stable" enrichment

The actual transfer of wealth to the beneficiaries, where a "stable" attribution is involved, fulfils the conditions for the application of italian gift and inheritance taxes.

As to the definition of such "stable" transfer, according to the Italian Tax Authorities, reference should be made primarily to the clauses of the Trust Deed and Deeds.

New and particularly interesting is the Italian Tax Authroties' view according to which such "stable" attribution may also be identified at the time of the trust deed or disposition of the assets into trust (or at a later time of the trust's life time), when the beneficiaries are already originally identified (or identifiable) and holders of a full and enforceable rights "*not subordinated to the discretion of the trustee or settlor*".

This can provide, *from a tax planning perspective*, an interesting pliability to the instrument, adapting it both to the usual specific needs and to the possible assessment (of convenience) in anticipating the tax burden associated with gift and inheritance tax (because it is believed, for instance, that these taxes might increase in the future).

Territoriality criteria and taxable base

The Italian Tax Authorities confirm that the territoriality criteria for the application of IHT should be addressed at the moment the asset are transferred by the Settlor to the Trust. In other words, it would be possible to conclude that if at the time of the disposition the settlor was not resident in Italy and the assets transferred into trust were no sourced in Italy, no gift or inheritance tax will be due upon actual and stable distribution to the beneficiaries. **Case by case analysis should be made – in terms of cost-effectiveness – with reference to individual (e.g. HNWIs) wishing to move to Italy.**

Moreover, the Circular Letter no.34 clarifies that the appicabile IHT rate (from 4% to 8%) and exemption thresholds (up to €1Mln), as well as the asset's value, would be assessed at the time of the final attribution to the beneficiary.

The "Income" and "Capital" dinstinction

When proper distintion is accounted, according to Italian tax rules, the Capital initially disposed to the trust is going to be treated at "exit" as an attribution subject to IHT. Income generated by transparent or non trasparent trust, therefore already subject to taxation, are therefore treated as exempt for IHT purposes in order to avoid double taxation. This issue will be further discussed and it is of utmost importance for trustees and protectors to make an assesment on the specific case of the trust.

"Informal" and "stable" attributions

In the **case of "informal" distribution**, the beneficiary may have the chance to pay gift and inheritance tax in the occasion of the **vesting rights to a beneficiary**.

This is relevant on certain cross border issues in relation to existing trusts as well as with a view for future estate planning in full compliance.

Disposition of assets in trust under the previous "entry-taxation" position

A further main novelty concerns the **tax treatment for those who have already paid IHT** in the past, following the previous positions of the Italian Tax Authorities (according to which IHT was due on the asset transfer to the Trust). In such a case, **no further IHT is due if all the following requirements are met**:

- the asset transferred to the beneficiary are the same as those initially transferred to the Trust Fund, and
- the beneficiaries are identical to those initially provided in the Trust deed.

On the contrary, the IHT already paid will be deducted from those due to the final transfer. Alternatively, the taxpayer may file for a refund when specific requirements are met. **It is strongly recommended** that the trustee assess, according to specific convenience and on the basis of the individual case, whether to proceed or not to file for reimbursement and/or to consider making a "stable allocation" in favour of the beneficiaries.

TAX MONITORING

Italian Tax Authorities also gave their views on the interaction between the **Italian Tax Monitoring obligations and trusts** in the light of Legislative Decree No.90/2017 (implementing IV AML EU Directive 2015/849).

The Circular admitted that by an interpretative "solution", such rules apply to an individual who

qualifies as "beneficial owners" of the asset held in the Trust Fund. The Italian Tax Authorities state that provisions adopted under Common Reporting Standard should also be taken into account for identifying beneficial owners.

Regarding **trust residents in Italy for tax purposes**, the Trust must comply with Italian tax monitoring obligations to the extent no other beneficial owners are obliged to. On this regard, **the beneficiary is regarded as a beneficial owner when he is vested or can be easily identifiable.**

No tax monitoring obligations arise upon **second-degree beneficiaries** (i.e., nephews of the settlor when first beneficiaries are the issues) as far as they cannot claim, not even potentially, any distribution from the Trust. Similarly, Italian Tax Authorities confirm the view that **trustees, trust officers and protectors** are not obliged to Tax monitoring as far as the Trust gives them no right to the Trust Fund.

Finally, Italian Tax Authorities address several cases involving **Italian resident beneficiaries of opaque foreign trusts**. More in detail, a distinction should be made depending on the **discretionary** or **non-discretionary nature** of the Trust:

- Beneficiaries of **non-discretionary trusts** shall fully comply with the tax monitoring obligations and, therefore, to report the value of the investments held abroad by the entity and the foreign assets of a financial nature in its name, as well as the percentage of assets in the entity.
- Beneficiaries of **discretionary trusts**, on the other hand, are obliged to disclose, on the basis of the information available (where, for example, the trustee discloses his decision to allocate the income and/or capital of the trust fund to him), the amount of the claim against the trust and the investments and financial assets held abroad.

Wealth Taxes

The Circular confirms what is already stated in the Draft, taking the opportunity to clarify the functioning of the "Property Tax on Real Estate Held Abroad – IVIE) and on "Net Wealth Tax on Financial Assets Held Abroad – IVAFE).

It is recalled, on this regard, that resident individual, non-commercial companies (i.e., società semplice) and entities (i.e., trusts) are obliged to pay IVIE and IVAFE for assets held abroad. As the only novelty compared to the Draft, the Circular Letter now clarifies that Italian resident beneficiaries of a foreign opaque Trust are not subject to IVIE and IVAFE to the extent they don't hold a legal right on the foreign real estate and financial assets.

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At a Glance

Circular n. 34/E set new guidelines which have a positive influence on trust and estate planning associated to Italy and/or Italian tax resident beneficiaries of international trusts.

In particular the Italian Tax Authorities:

- Gave clear guidelines on **commercial** e **non commercial** trusts
- Clarify tax residence and coordination with previous guidelines, with a particular attention to "**opaque**" and "**transparent**" trust **for direct taxation purposes**.
- Clarify the opportunity to keep **dinstinction between "capital" and "income" accounts**, according to Italian tax rules.
- Confirmed the definition of "**Low Tax Jurisdiction**" for the tax residence of foreign trusts.
- Clarify the meaning of **discretionary trusts.**
- About **indirect taxation**:
    - Clarified that no tax is to be given at disposition time ("entry")
    - Clarified that taxes, as regulated by Italian TUS (e.g. IHT and Gift Tax) are to be paid on the value at "exit" time.
    - "Exit" is to be regarded when a pemanent "stable" attribution is given to beneficiaries, opening to the concept of vested and unvested beneficiaries for tax purposes too.
    - Conveniently distinction between "capital" and "income" for IHT and Gift Tax too.
- About **fiscal monitoring** confirmed the rules and shared some peculiarities with exchange of information (eg. CRS) and trusts.
- Gave interesting confirmation about the meaning of **interposed trust**, with useful bestpractice for foreign individuals and/or individuals who moved their residence to Italy (eg. New Tax Resident with 100k flat taxation).

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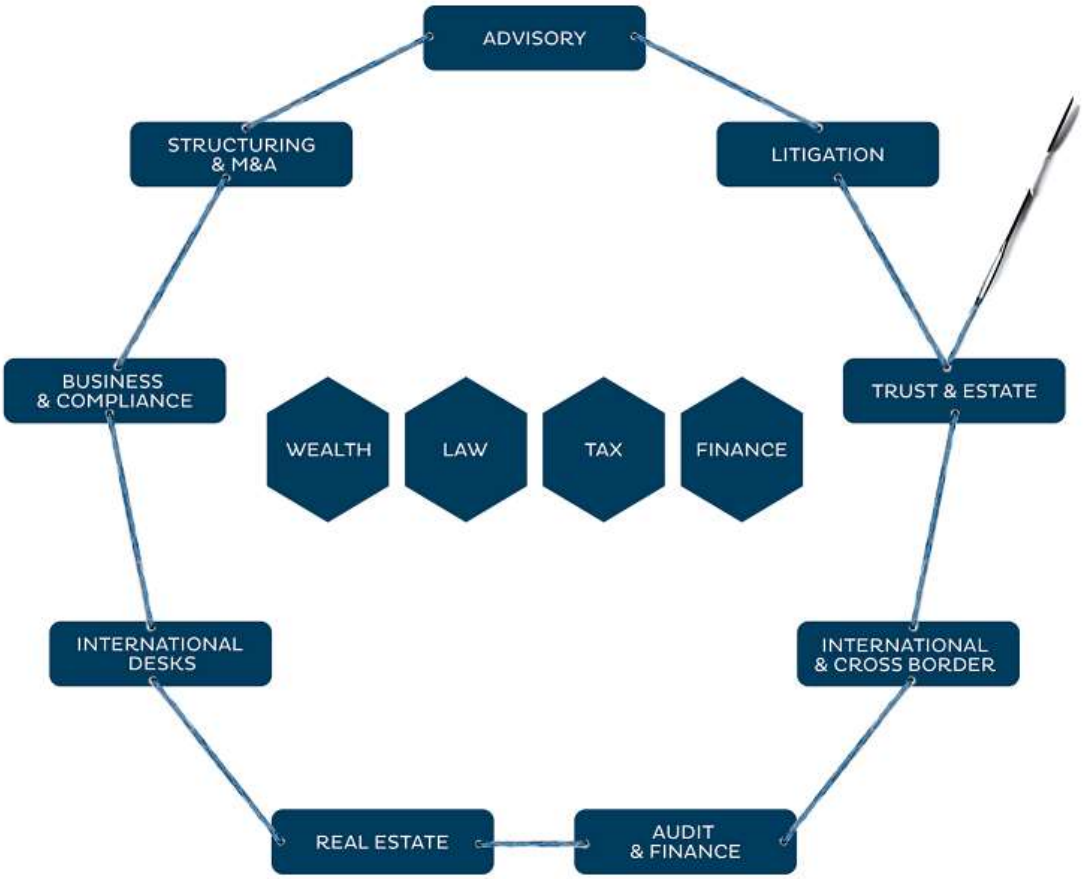

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