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Stop Press - Taxation of Trusts in Italy

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CATEGORY:
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Background

As indicated in a previous Stop Press, the Italian FA 2007 (which came into force on 1 January) introduced new rules on the taxation of trusts. In a nutshell, under the new rules:

(a) transfers of property to trusts are subject to the newly re-introduced gift/succession tax, (subject to certain thresholds for close relatives and business property relief for qualifying shares);

(b) trusts are treated in a manner akin to companies;

© trusts established in countries other than those which appear on Italy's 'white list' are deemed to be resident in Italy; and

(d) the income of the trust is automatically attributed to the beneficiaries in certain circumstances, regardless of distributions.

Guidelines

On 6 August, the Italian tax authorities published guidelines to deal with some of the interpretative issues raised by the new rules.

Gift and succession Tax

The guidelines clarify that gift / succession tax is only chargeable on the transfer of assets from the settlor to the trustee(s) and not, as previously sugegsted by the tax authorities, also on distributions to beneficiaries. In addition, the guidelines confirm that the applicable tax rate is determined by reference to the degree of relationship existing between the settlor and the beneficiaries, rather than the one existing between the settlor and the trustee(s). In practice, where a settlor transfers assets to professional trustees for the benefit of his spouse and descendants, the applicable tax rate will be 4%, rather then 8% (which is the tax rate applicable to transfers to non-related persons). In addition, in the example just mentioned, each beneficiary will benefit from an exemption of €1m. It is not clear how the exemption will be calculated in practice if the trust is in favour of an open class of beneficiaries, or if it is favour of one beneficiary if he survives and a class of others if he does not.

Residence of trusts – actual and deemed

Under Italian law, companies (and now, also trusts) are resident in Italy if their seat or place of administration is situated in Italy or their principal object is carried out in Italy.

The extension of company law terms to trusts gives rise to interpretational issues and the guidelines explain that, in the case of a trust whose trust fund is comprised of immovables situated in Italy, the 'object' of the trust will be situated in Italy. In the case of movables, the 'object' of the trust (and therefore the residence of the trust) will have to be determined by the nature of the trust's activity. In practice, an offshore trust holding exclusively non-Italian assets should not be held to be actually resident in Italy.

Deemed residence

The Italian FA 2007 introduced a rebuttable presumption that the trust is resident in Italy if:

(a) at least one of the settlors and one of the beneficiaries is resident in Italy; and

(b) the trust is not established (' *istituito*') in a country which appears on the 'white list' of countries which exchange information with Italy.

In addition, a trust which is not established (' *istituito*') in a white-listed country.is treated as resident in Italy if, after its creation, an Italian resident adds immovable property or rights related to immovable property to it.

The guidelines clarify that, for the purposes of this anti-avoidance rule, the settlor's residence has to be determined as at the time the trust is formed. Accordingly, if a non-Italian settlor establishes a trust and subsequently moves to Italy, the trust will not be caught by the new anti-avoidance rules. By contrast, the residence of the beneficiaries has to be determined on a year-by-year basis. Interesting issues arise where the settlor is a member of the class of beneficiaries.

The guidelines are less clear as to which factor determines whether a trust is established (' *istituito*') in a particular country. In principle, the following factors may come into consideration: the residence of the trustee, the place of administration of the trust, the place where the trust deed is executed/the trust assets are transferred to the trustee(s) and the proper law of the trust.

The guidelines explain that "the new rules are aimed at catching avoidance schemes designed to fictitiously locate 'internal' trusts (i.e. trusts with an Italian settlor, Italian beneficiaries and Italian assets) in countries which do not exchange information with Italy. In essence, the relevant factor is whether a trust, the elements of which are connected with Italy (an Italian settlor and Italian beneficiaries or Italian immovables), is 'established', i.e. formally resident in a country which is not included on the white list."

The reference to the 'formal residence' of the trust and the rationale of the anti-avoidance provision (exchange of information) seems to suggest that the Italian tax authorities' analysis will focus primarily on the residence of the trustee(s) and/or the place of administration of the trust, as this is where the information about the trust is held. However, the guidelines stop short of listing the relevant factors.

As a result, there remains an area of uncertainty, although careful planning should minimise the risks of the trust being caught by the new deemed residence provision.

Tax treaties

The new guidelines confirm that, as trusts are treated on the same footing as companies for the purposes of determining their residence, they should also be treated as 'persons' for the purposes of Italy's double tax treaties.

Attribution of trust income to beneficiaries

The Italian FA 2007 provides that "where the beneficiaries have been identified / specified ('*individuati*'), the income of the trust shall, in any event, be attributed to the beneficiaries by reference to their shares as identified ('*individuati*') in the trust instrument or in any subsequent document, failing which, in equal shares".

The guidelines clarify that the automatic attribution of income does not apply to a discretionary beneficiary until and unless he has been 'identified' as the recipient of that income, i.e. until an appointment/ distribution. In other words, what counts is not the identification of the beneficiaries, but the identification of their right to receive income. This clarification puts an end to the raging debate within the Italian professional community that had led to the drafting of extravagant clauses aimed at avoiding the identification of beneficiaries in the trust deed.

Other issues

The guidelines also deal with the income, capital gains tax and VAT issues related to the transfer of assets to trustees and to distributions to beneficiaries as well as the crediting of tax paid by the trustee(s) in circumstances where the income is automatically attributed to the beneficiaries.

Conclusions

The publication of the Italian tax guidelines sheds light on a number of interpretational issues and is evidence of the maturity of the Italian legal system. However, the extension of corporate law principles to trusts complicates the legal analysis, as is displayed by the Italian tax authorities' inability (or unwillingness) to define the 'seat' of a trust or the factors which determine the place where it is established. Incidentally, similar issues arise in Switzerland where the jurisdiction of the courts in trust matters is defined by reference to the 'seat' of the trust.