

# Trusts and taxes: new challenges for families

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Recent changes in the taxation of trusts have made estate planning more complicated in some European countries as well as the U.K. Both the U.K. Finance Act of 2006 and the Italian Finance Act of 2007 (which went into effect on January 1) have created new landscapes for estate planners in both countries.

In Italy, trusts are now treated as companies. The new law is designed largely to catch tax avoidance schemes that fictitiously locate trusts outside the country that have an Italian settlor, Italian beneficiaries and Italian assets. Italian law specifies that companies (and now, trusts as well) are treated as residing in Italy if their place of administration is in Italy or if their principal object is carried out in Italy.

Trusts established in countries that do not appear on Italy's "white list" are automatically deemed to be resident in Italy.

When property is transferred to a trust, the transfer is subject to the newly reintroduced gift/succession tax, but the tax only applies to transfers from the settlor to the trustee, not on distributions to beneficiaries. In addition, the rates are relatively moderate (4 to 8 percent).

In the U.K., by contrast, trusts are not treated as companies. Trust income and gains are taxed in the hands of the trustees, and in some circumstances also in the hands of the settlor or the beneficiaries. If a settlor can benefit from a trust, any income or capital gains realized by the trustees are attributed to the settlor. Even if the settlor is excluded from the benefits of the trust, gains will be attributed to him if his spouse, children or spouses of children can benefit.

In what has been widely considered as an attack on trusts, the Finance Act of 2006 changed the inheritance tax rules concerning trusts, so that nowadays most trusts (whether grantor trusts, life interest trusts or discretionary trusts) are subject to an entry charge of 20 percent and 6 percent (with limited exceptions) every decade. On the other hand, the rules concerning people who are not permanent residents remain favourable, so that the U.K. continues to remain a tax haven at the heart of the EU.

New rules also adapt Controlled Foreign Company ("CFC") rules to trusts, in an attempt to prevent the phenomenon of "parking" foreign income and capital gains offshore.

Changes in both jurisdictions have led to complex challenges for estate planners and their clients. In some cases, there are provisions with unclear language whose meaning has yet to be tested in the courts. We keep a close watch on these developments and are always ready to help families navigate the new landscape with confidence.

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