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Draft Circular Sheds Light on Tax Ramifications of Italian Taxation of Trusts

This note examines the tax treatment of trusts in Italy in light of a draft Circular of the Italian tax authorities, published in August 2021, on Italian tax provisions related to trusts.

1. Introduction

This article takes a closer look at the tax treatment of trusts from a domestic point of view. Trusts, in fact, are attracting increasing interest, as they combine the protection of certain interests with a degree of flexibility that is unparalleled in the market.

The occasion for this in-depth study is the publication, in August 2021, by the Italian tax authorities of a draft Circular on the Italian tax provisions related to trusts. It was released for comment by practitioners in the field, for example, tax firms, law firms and trade associations, with the intention of publishing the final version once the observations received are considered. This is a long-awaited intervention, as it represents the latest guidance on the topic in the form of a circular (with the last circular dating back several years, i.e. Circular no. 61/E of 2010).

As the Circular is still in draft form, this article will concentrate specifically on certain tax points dealt with in the Circular with a view to evaluating the position of the Italian tax authorities. A further article might be warranted in the future to explore various other themes once the final version of the document has been issued.

Trusts, as a form of legal instrument, were introduced into the Italian legal system in conjunction with the ratification of the Hague Convention of 1 July 1985, by a Law of 16 October 1989, no. 364, which has been in force since 1 January 1992.

A trust substantially consists of a fiduciary legal relationship pursuant to which an entity (typically an individual) defined as a “settlor” enters into a unilateral transaction for the settlement of the trust through a “founding act” (also known as a “deed of trust”) in order to transfer to another entity, defined as the “trustee”, assets (of any nature). Consequently, the latter must manage and administer them in accordance with the provisions of the founding act for the purposes identified by the settlor for the benefit of the recipients (or “beneficiaries”). The framework sometimes provides for the presence of a “guardian” who, while not having managerial powers, merely ensures that the trustee’s actions are fully in line with the settlor’s wishes.

In recent years, several types of trusts have been implemented according to various aims being pursued. Generally, the purpose is the devolution of assets to other entities, defined as “beneficiaries”, at the end of the trust, as in the case of a “trust of family interest”, established to facilitate succession, or for other purposes (for example, under a “trust guarantee” or where a “trust liquidator” is established to carry out a liquidation of the assets of a company for the satisfaction of creditors).

The growing interest and use of this flexible instrument has raised several questions about its tax treatment and monitoring obligations. Due to the uncertainties surrounding trusts, a clear position taken by the Italian tax authorities is all the more appreciated. The tax regime applicable to trusts has recently been the subject of innovations (i) by the Italian legislator in relation to the direct taxation of a trust located in a tax haven, (ii) in several court decisions with regard to indirect taxation at a time when the settlor’s assets are assigned to the trust and (iii) in relation to tax monitoring obligations and the application of Italian wealth taxes.

2. The New Provisions of the Italian Tax Authorities

2.1. Direct tax provisions

As a general rule, according to Italian tax law (article 73 of the Income Tax Consolidation Act),[1] resident and non-resident trusts are treated as taxable persons for corporate income tax purposes (i.e. IRES, which is levied at a rate of 24%).

In relation to Italian resident trusts, the income will be taxed on the basis of the worldwide taxation principle and, therefore, all income, regardless of where generated, is subject to the IRES, while income arising in the hands of non-resident trusts is subject to IRES in respect of income produced in Italy.

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1. IT: Income Tax Consolidation Act, Presidential Decree no. 917/1986 [*Testo Unico delle Imposte sui Redditi*, ITA].

For income taxation purposes, there are two types of trusts: ones without identified (income) beneficiaries whose income is directly attributed to the trust itself ("opaque trust") and those with identified income beneficiaries whose income is allocated, based on transparency, to the beneficiaries ("transparent trust").

Note that, as per the Circular of 6 August 2007, no. 48/E,[2] the "identified beneficiary" is the recipient promptly identified and the holder of the actual right to claim, from the trustee, an allocation of that part of the income that is attributed to him based on transparency.

With regard to a transparent trust, for direct taxation purposes, its income, regardless of where earned, is assigned based on transparency to the beneficiary (Italian tax resident) as capital income[3] and, if the beneficiary is an individual, "in proportion to the share of the participation identified in the founding act of the trust or in other subsequent documents or, in the absence thereof, in equal parts".[4]

When – at the time of the related payment in favour of the beneficiaries – a withholding tax or a substitutive tax has been applied to the income, the latter does not contribute to the tax base (neither on behalf of the opaque trust nor the beneficiaries of the transparent trust).

Taxation of the beneficiaries of the transparent trust is applied based on an imputation criterion. This implies that "independent" of an actual transaction where the beneficiaries collect/are paid out, such income is taxed in the hands of the identified beneficiaries because of the transparent nature of the trust. Distributions/payments of amounts that had already been taxed due to transparency will not be further taxed at the time of distribution/payment in order to avoid economic double taxation.

Opaque trusts, however, are subject to taxation in the hands of the trust itself and there is no transparency income attribution phenomenon.

With regard to foreign opaque trusts located in states or territories that, by reference to the revenue produced by the trust, are considered to be subject to privileged taxation within the meaning of article 47-bis of the Income Tax Consolidation Act, the income attributions by the trust are subject to taxation in the hands of the resident beneficiaries pursuant to g-sexies, paragraph 1 of article 44 of the Income Tax Consolidation Act as capital income. There is no possibility of demonstrating "effective economic placement" (i.e. the genuineness of localization in those countries through an organized structure) in such territories through a ruling based on the Italian tax authorities' opinion as confirmed in the aforementioned draft Circular. In particular, a regime is privileged where the nominal (not effective) level of taxation is less than 50% of that applicable in Italy as moreover clarified in the draft Circular.

Attributions/distributions to Italian resident beneficiaries by foreign opaque trusts are subject to taxation in Italy based on the cash principle (they are taxed only when income is actually received), which generally regulates the taxation of capital income, as opposed to transparent trust allocations, in respect of which the imputation criterion applies.

Under the current legislation, a presumption would be triggered in the event that it is not feasible to make a distinction between the assets (in the initial balance sheet and any subsequent transfers made by the settlor (or third parties) to the trust) and the income (consisting of any income earned by the trust). In this event, the entire amount received by the beneficiary resident in Italy is qualified, for Italian tax purposes, as capital income.

A solution to avoid the application of the aforementioned (penalizing) presumption could be the implementation, by the trustee, of an analytical accounting system that distinguishes the allocation attributable to the value of the trust assets (i.e. the initial contribution and subsequent transfers, if any), net of any attribution of assets to the beneficiaries, from that part attributable to annual income, net of any allocations to beneficiaries.

2.2. Tax provisions for indirect income purposes

In recent years, the view of the Italian Supreme Court of Cassation has fluctuated in relation to the indirect tax treatment of a transfer of assets to a trust, generating uncertainty and doubt amongst practitioners in the field. It is only recently that the Court of Cassation has adopted a clear line of case law.

According to the new interpretation provided by the Italian tax authorities emerging from the draft Circular discussed herein, the gift tax[5] does not apply when the assets are initially transferred to the Italian trust by the settlor but only when they are to be distributed to the beneficiaries: based on this perspective, the founding act (and the other deeds of asset attribution) govern the transfer of assets that are instrumental to fulfilling the purposes of the trust. This does not translate into actual transfers of wealth from the settlor to the trustee. In the case at hand, an effective transfer of wealth, through a "concrete" allocation of wealth, takes place only when the asset is attributed to the beneficiary.

In relation to the founding act and the subsequent deeds of asset attribution to the trust, only a fixed stamp duty of EUR 200 is due pursuant to article 11 of the Tariff, first part, of Presidential Decree no. 131 of 26 April 1986.[6]

2. IT: Circular of the Revenue Agency [*circolare dell'Agenzia delle entrate*] no. 48/E of 6 Aug. 2007.
3. In general, capital income may be defined as income from the use of money and other financial assets received in the performance of business activities. Art. 44 ITA does not provide a definition of "capital income" but lists the situations that fall within that category of income. For example, dividends and other income from participation in the capital or assets of a company are considered capital income.
4. According to art. 73(2) ITA.
5. Inheritance and gift tax was introduced in Italy by IT: Legislative Decree no. 346/1990 and it is due on any transfer of property or other rights in the event that a person benefits from a *mortis causa* asset enrichment or by way of donation.
6. IT: Presidential Decree no. 131 of 26 Apr. 1986.

Some questions may arise for those taxpayers who already paid gift taxes at the time of the settlement of the trust based on the previous interpretation of the Italian tax authorities. Therefore, it is necessary to carefully, and in a timely manner, analyse the solutions and the arrangements for claiming back sums that were unduly paid (provided that this is possible). A concrete solution might be for the taxpayer to send a refund application to claim the tax paid that was not due. The authors are aware that there are deadlines for submitting a refund claim (typically 48 months) and, therefore, in some instances, the deadlines may have expired. These practical issues should be further clarified by the Italian tax authorities.

2.3. Tax monitoring obligations and the application of Italian wealth taxes

The Italian law regarding tax monitoring was amended by Legislative Decree no. 90 of 25 May 2017.[7] It provides that the obliged Italian tax resident individuals are required to file the RW-form – included in the Italian tax return – to disclose their real estate properties, investments and foreign financial assets – including those subject to a trust – held abroad.

According to the current legislation, the transparent Italian resident trust shall comply with the tax monitoring requirements by indicating the value of the foreign assets and the percentage of assets not attributable to the resident beneficial owners: the beneficial owners are "identified or easily identifiable" by the founding act or by other documents, even indirectly.

Therefore, whether the foreign opaque trust's founding act or other documentation clearly identifies the beneficiaries of the trust or makes them easily identifiable (for example, the direct descendants of the settlor), the latter – if Italian tax resident – are required to file the aforementioned RW-form, even if they have no right to receive income produced by the trust. Furthermore, the beneficiaries of an opaque trust may not be aware of their own status as recipients and, in this respect, an amendment by the tax authorities to the current rules is strongly requested by practitioners in the field, which could be in the form of comments on the draft Circular. For the sake of completeness, considering (i) that the status of beneficiaries of trusts listed, but not identified, is comparable to that of beneficiaries of a life insurance policy or a will, in respect of which the tax authorities have never taken a position on tax monitoring obligations, and (ii) the OECD Common Reporting Standard provisions on beneficial owners in paragraph 253 of the Implementation Handbook, one would expect a review of the position expressed in the draft Circular at hand.

As a general rule, Italian tax resident individuals required to comply with tax monitoring requirements are obliged to pay Italian wealth taxes (i.e. IVIE and IVAFE)[8] in respect of investments and financial assets held abroad: IVIE of 0.76% is due calculated based on the real property's purchase cost, in proportion to ownership and the months of possession. Further, IVAFE of 0.2% is due, calculated based on the value of financial assets, which are divided further into "financial products", "bank accounts" and "bank saving books".

3. The Trust as a Wealth Planning and Protection Tool

In summary, the authors think that trusts are an invaluable tool in respect of wealth planning and asset protection in particular cases.

In fact, the "*dopo di noi*" Law (no. 112/2016)[9] aims to enable parents of people with disabilities to provide for a future time when, due to advanced age or death, they can no longer care for their child who is unable to cope independently with the problems of daily life. In establishing a trust for the benefit of a child with a disability, article 6 of the aforementioned law, in fact, provides for an exemption from inheritance and gift tax, as well as relief from mortgage and cadastral taxes, if certain requirements are met.

As a general comment, the authors note that the trust instrument can be successfully applied in a tax context despite the fact that this area, from an Italian point of view, is still uncertain.

The main areas to be clarified by the Italian tax authorities, some of which arise from the publication of the draft Circular, relate to (i) the tax residency of the trust in the event that there are two or more trustees and they reside, for tax purposes, in two or more countries, (ii) the treatment of gift tax already paid at the time of the settlement of the trust and possible remedies for claiming back sums that were unduly paid based on the previous interpretation of the Italian tax authorities and (iii) the payment obligation in respect of Italian wealth taxes on assets held in trust (IVIE and IVAFE) and monitoring obligations.

The authors feel that greater regulation of the trust instrument, particularly in terms of the tax framework, could encourage further development of structures that incorporate foreign entities and international assets.

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7. IT: Legislative Decree no. 90 of 25 May 2017.
8. IVIE and IVAFE are Italian wealth taxes due, respectively, on real estate and financial assets held abroad (stocks/securities/dividends/interest, etc.) by an Italian tax resident.
9. IT: Law no. 112/2016 of 22 June 2016 on assistance for persons with severe disabilities without family support.