

News on Trusts

On the 27th of December 2010 the Italian tax authorities issued Circular Letter 61/E on Trusts. The circular letter details the Tax Authority guidelines and interpretation of trusts direct taxation, together with a general assessment of different kinds of trusts, with a view that some trusts might not be considered valid under fiscal rules (so called "fiscally ineffective" trusts).

In practical terms trusts affected by this circular will be treated as fully look through for Italian purposes and could result in a liability to Italian tax for the Settlor which could have significant implications for trustees and beneficiaries alike.

This circular impacts on both Italian resident trusts with non resident beneficiaries and non Italian resident trusts with Italian resident beneficiaries.

Which trusts are affected may not be immediately apparent but in the main any trusts with an Italian connection should be reviewed. At a minimum reviews will help to identify what adjustments are required to be made to the governing trust deed and or any underlying structures as well as any action that may need to be taken by the beneficiaries/trustees.

We outline below a summary of the changes for your consideration.

The team at Belluzzo & Associati comprises of Italian, UK and international trust and tax specialists with specific expertise in trusts from an Italian perspective and can provide assistance with these changes.



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TRUSTS – PRINCIPLES AND CHARACTERISTICS

According to the Italian Tax code trusts are liable to Ires (corporation tax) depending on which of the following category they belong to:

1. Trusts which are resident in the state territory (Italy) and whose principal objective is to exercise a commercial activity;
2. Trusts which are resident in Italy and whose principal objective is not to exercise a commercial activity;
3. Trusts which are not resident, but revenue/income arises in Italy.

For tax purposes, it is possible to classify trusts in two different categories as follows:

1. Trusts where the beneficiaries are identified (Transparent Trusts “Trust trasparenti”), where the income is attributed to the beneficiaries for tax purposes; and
2. Trusts where the beneficiaries are not identified (Opaque Trusts – “Trust opachi”); where the income is not attributed to the beneficiaries and remains only trust income until it is distributed.

It is important to realise that a trust is regarded as "transparent" for Italian tax purposes only when a beneficiary has a "vested" right to income, i.e. the name of the beneficiary and the benefit attributable to him are irrevocably established in the deed and the trustee has an obligation to transfer the income to such a beneficiary.

It is possible to have a mixed trust – “Trust misto”. This particular type of trust arises when a trust deed provides that part of the income of the trust is accreted to capital and part is distributed to the beneficiaries. In such case, the trust will be liable for Ires taxation (corporation tax) on the part of income not distributed, while the part distributed will flow through to the beneficiary(ies).

Some specific provisions of the Italian code clarifies the residence position of trusts established in countries with which Italy does not have an “information exchange” agreement. **Trusts established in any of those countries will be considered as having Italian fiscal residence and thus be liable to tax in Italy if at least one settlor and one beneficiary have fiscal residence in Italy.**

Trusts – Principles and Characteristics

As envisaged in The Hague Convention, 1 July 1985, and as ratified into domestic law on 16th October 1989 by Act No 364, the essential characteristic of trusts are:

- The title to the trust assets is with the trustee (legal owner);
- Segregation of trust assets; the trust assets constitute a separate fund and are not a part of the trustee's, the settlor's or the beneficiaries' personal estate;
- The power and duty of trustees to govern, manage and dispose of the assets is in accordance with the trust deed and domestic law (if any).

The Impact of the Circular

In order to establish how a trust is treated for Italian tax purposes, **a key issue now is whether the trustee has actual decision making powers.** Trusts directly managed by or under the control of the settlor are regarded as fiscally ineffective for these purposes. In fact, if the settlor controls the activities of the trust or the trust fund, it means that the transfer of the assets has in substance never really taken place. **The logical consequence of this is that the settlor now can be treated as directly taxable on trust income and gains.**

The circular indicates that trusts can be regarded as "**fiscally ineffective**" for Italian tax purposes in the following cases:

- Trusts where the settlor has the express power to terminate the trust anytime for its own benefit or the benefit of third parties;
- Trusts where the settlor has the express power to at any time appoint himself as beneficiary;
- Trusts where the trustee cannot make decisions without the settlor or beneficiaries' consent;
- Trusts where the settlor has the express power to terminate the trust before the termination date and appoint himself or others as beneficiaries;
- Trusts where the beneficiary has the express power to force the trustee to distribute a share of the trust assets;
- Trusts where the trustee has an obligation to follow the settlor's directions;
- Trusts where the settlor has the express power, during the life of the trust, to change the beneficiaries;
- Trusts where the settlor has the express power to assign trust assets or to give out loans;
- Where the settlor or the beneficiaries are able to influence or vary the trustee's decision making ability.

International Trusts – Italian Resident Beneficiaries

It is important to realise that for these purposes **express power can be interpreted as arising either when it is written in the trust deed or where it takes place in practice**. As a result the impact of these changes can be potentially extremely wide ranging for settlors, trustees as well as beneficiaries.

The above means that there is a significant risk that these changes could give rise to Italian tax exposures for settlors, trustees as well as beneficiaries.

The circular also addresses the taxation of international trusts and their beneficiaries.

In tandem with previous circulars the income of these trusts is attributed to the beneficiary of the non-resident trust (Art 73 s (2)), and is to be considered as capital income for Italian tax purposes. **The beneficiary is therefore liable to tax in Italy regardless of the trust location or where the income arose**. Nevertheless, if the income arose in Italy and therefore is already taxable the beneficiary will not be subject to further taxation.

It appears that the Italian Tax Authority is now interpreting the position vis a vis international opaque trusts differently.

The revised interpretation is based on the assumption that these trusts can be used for tax avoidance purposes in which case the beneficiaries can expect to be taxed when they receive income from the trust.

Foreign Beneficiaries of Italian Resident Trusts

Conclusions

In case of non-resident beneficiaries of an Italian resident transparent trust, the income attributed to the beneficiary is considered arising in Italy, as seen in Art 23 (b) of the TUIR.

Any such income will be taxed as soon as it is attributed to the beneficiary and not necessarily at the time it is received by the beneficiary. This is in line with the general principles of Italian taxation and as such accords with previous interpretations; as a result there is no significant change here. It will however be mandatory that foreign beneficiaries of an Italian resident trust comply with this rule, which gives rise to Italian tax filings and payment obligations.

All trust structures with an Italian connection should be reviewed in the light of the above changes. In some cases it will be necessary to amend trust deeds and potentially the modus operandi of the administration of the trust including protector arrangements.

Such reviews are essential in order to reduce the risk of tax for the trustees as well as beneficiaries. Following the Scudo and the above changes it is likely that there will be more attacks on trust arrangements by the Italian Tax Authorities as well as potentially long and difficult tax litigation in certain cases where non compliance with Italian tax law is uncovered.



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Firm

Belluzzo & Associati was established by Umberto Belluzzo in 1982 to advise Clients in all aspects of business activity and development. Our professional associates work in synergy to offer interdisciplinary consultancy in the fields of Tax, Legal, Accounting and Estate Planning.

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