TRUST & ESTATE PLANNING (TEP)

Overview of Italian use and taxation of trusts

By Prof Stefano Loconte

Although Italy is a civil law country, it has recognised the common law trust since 1992 with the adoption of The Hague convention of July 1985, but up until now, the Italian civil law code has not contained any provisions concerning trusts. However, it is possible to set up a trust with foreign law subject to The Hague Convention and in accordance with public policy. In Italy, domestic trusts are considered to be those that have only their proper law as a foreign element.

From a fiscal point of view, the Finance Act 2007 introduced into tax legislation direct tax on trust income with the renovation of Article 73 of the Italian Income Tax Code (TUIR), for individuals and corporations.

According to this article, a trust is considered a tax entity subject to corporate tax (IRES) at a rate of 27.5% only if it has no identified beneficiaries (an "opaque trust").

In contrast, if a trust has identified beneficiaries (a "transparent trust") it is not taxable, because the beneficiaries are taxed directly by personal income tax (IRPEF), which is attributed in proportion to their share of the trust's income.

The Italian Revenue Service allows

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for the possibility that a trust may be simultaneously transparent and opaque (a "mixed trust").

Trusts which are resident in Italy are taxed on their worldwide income, while trusts which are not resident in Italy are taxed only on the income produced in Italy.

It has to be taken into account that, according to Article 73 of the TUIR, trusts are considered resident in Italy for tax purposes if at least one of the following conditions is met for a period of time that is greater than half of the tax period:

i. place of incorporation;
ii. place of administration of the entity;
iii. place where the main and substantial activity is carried out.

Trusts are presumed to be resident for tax purposes in Italy - if they are settled in a non-whitelisted state or territory and if at least one of the settlors and one of the beneficiaries are resident in Italy. Trusts incorporated in non-whitelisted states and territories are also presumed to be fiscal resident in Italy when a resident person makes a contribution of real property rights to the trust.

Additionally, trusts may alternatively qualify as commercial or non-commercial entities depending on their prevailing activity.

The new provisions introduced by the Finance Act 2015 have an impact on the taxation of trusts qualifying as non-commercial entities (i.e. "holding trusts"), changing the tax rules for non-commercial resident entities receiving dividends, including bank foundations, foundations, and also trusts.

Before the Stability Law 2015 entered into force, the tax base used to be only 5% of the received dividends, as it is still for commercial entities (Article 73 TUIR), with a tax rate of 27.5% (IRES). Therefore the effective tax burden used to be 1.38%. From January 1st, 2015, the tax base has been increased to 77.74% of the received dividend, with the consequence that the effective tax burden is 21.38% as at today. The aim was to give no advantage compared with the taxation on individuals. The new law is therefore removing a tax advantage by applying the same taxation to those entities as it does to individuals.

It is nonetheless worth nothing that the Stability Law 2016 reduced the IRES tax rate from 27.5% to 24%, effective from January 1st, 2017.

Finally, when talking about fiscal monitoring, it is necessary to clarify that resident individuals, trusts and other equiparable legal entities who own investments abroad or are involved in foreign financial activities have to indicate these in their tax returns (RW form).

The new Italian reporting rules may

affect both resident and non-resident trusts, trustees, settlors and beneficiaries.

By means of the so called European Law 2013 (Law of August 6th, 2013) the Italian legislator, in order to comply with European provisions and obligations, extended the scope of the existing reporting rules to include the resident beneficial owners – as determined by the Italian anti-money laundering discipline – of trusts or other entities who indirectly hold foreign assets.

In particular, it introduced the definitions of "direct or indirect control" and of "beneficial owner", adopting the same definitions that are contained in the Third Anti-Money Laundering Directive.

The new rules do not apply to foreign assets that are held via qualified Italian intermediaries, to the extent that any income/gains are subject to tax at the source or final withholding tax in accordance with the rules that apply to assets under administration/management by Italian qualified intermediaries.

So trusts can be a very useful tool for Italian private clients to manage their domestic or international assets as well as for cross border operations.

Estate planning is aimed at protecting and preserving one's assets not only during one's lifetime, but also thereafter, and the current situation and rumoured tax changes indicate that succession taxes are becoming more relevant and of concern to many more wealthy families.

These are the reasons why Italian high net-worth individuals (HNWIs) are currently very involved in setting up trusts to enhance their generation skipping and to cut their inheritance tax (IHT) bills, availing themselves of the current IHT regime in Italy, which is very profitable at the moment.