The Legal 500 & The In-House Lawyer

Hot Topic | Private Client (3rd edition)

Topic Author: Loconte & Partners

The use of trust in Italy

The institute of trust is increasingly getting used in Italy in the recent years, despite some difficulties mostly related to the fact that, as commonly known, Italy does not have a proper regulation for trusts.

Indeed, the institute of trust has been recognized in Italy through the ratification of the Hague Convention of July 1st 1985 (enforced with the Law n. 364/89 and came into force since January 1, 1992). The Convention pursued the aim of harmonizing the Private International law rules, related to trusts, in order to allow civil law countries to borrow the trust instrument from foreign jurisdictions whose legislation regulates the trust instrument properly.

It is therefore possible to set up trusts in Italy, thought the lack of domestic civil law rules entails the need for the tool to be regulated by the law in force in one of the Countries in which it is specifically regulated by law. This circumstance, however, does not mean that the trust qualifies as a foreign subject, neither from a civil law point of view nor for tax purposes.

A wide range of different uses of the trust instrument have been developed in Italy in spite of the harmonization with the Italian civil code jurisdiction. Family trusts are the first kind of trust used, above all trusts for disabled people and trusts set up for inheritance planning and for asset protection for family needs.

Types of trusts in Italy

There are many type of trusts in Italy, the main ones are represented by:

- purpose trusts and trusts with beneficiaries: when the trust fund is managed to achieve a goal, it is a “purpose trust”, whereas, when the trust fund is managed for the interests of one or more beneficiaries,

it is a “trust with beneficiaries”;

- trusts of public interest purpose (charitable trust): when the purpose of the trust falls within some categories that have been characterized over time at the jurisprudential level. The use of this type of trusts was less common in Italy then in the common law countries, but they are going to spread increasingly;
- fixed trusts and discretionary trusts: a trust with beneficiaries is called a fixed trust if the trust deed grants the beneficiaries rights on the income of the trust and on the trust fund. With the discretionary trust, the trustee will identify the beneficiaries, whether or not to assign benefits and how much should be distributed;
- protective trusts: it is a type of trust that is used if the beneficiary is prevented from having his own interests, or the creditors to execute acts of execution on those assets;
- self-declared trust: when the settlor appoints himself/herself as a trustee. It has been widely discussed between trust’s lawyer and experts and the Italian Supreme Court about the validity of this type of trust but nowadays it is listed among the trust recognized by the Italian jurisdiction.

Trust and forced heirship rule

The Article 15 of the Hague Convention states as follows: “*The Convention does not prevent the application of provisions of the law designated by the conflicts rules of the forum, in so far as those provisions cannot be derogated from by voluntary act, relating in particular to the following matters: […]*

1. *c) succession rights, testate and intestate, especially the indefeasible shares of spouses and relatives; […]*
2. *e) the protection of creditors in matters of insolvency; […]*.”

Indeed, with regards to succession rights, Italian law provides protection to the deceased closest relatives, and, to an extent, even if this is in contrast with his willingness. The spouse, descendants and, eventually, ascendants are in fact always entitled to receive a fixed percentage of the inheritance, which is reserved by law. To this end, the assets to be considered are both the ones available when the succession is open, and the donations made by the deceased during his lifetime, including the asset transferred to a trust. Therefore, if the remaining asset is not enough to meet the indefeasible shares reserved by law, the entitled relatives may take legal action against the trust, in order to obtain the restitution of the asset originally transferred by the deceased to the trust, within the limits of their indefeasible share (so called “*azione di riduzione*”).

Trust and creditors rights

A trust is not completely safe also from settlor’s creditors. The Italian Law indeed provides that

creditors could take legal action to render ineffective the transfer when the credit has been accrued prior to the transfer of assets to the trust and the settlor was aware to affect his creditors’ rights or, alternatively, the credit has been accrued after the transfer of assets to the trust, but anyway the settlor made the transfer specifically to avoid future creditors’ claims.

The trusts’ tax residence

Italian Tax Law has no specific rules for determining the trusts’ tax residence, therefore general principles regulating the tax residence for entities are applicable (article 73, par. 3, of Italian Code on Direct Taxation).

Those rules specify that entities are deemed to be tax resident in Italy whether they have in Italy for more than 183 days during the tax year: (i) the registered office, or (ii) the administrative office (effective management) or (iii) the main business.

With specific reference to the trust:

- the first criterion (registered office) is not applicable, since trusts are not autonomous legal entities;
- the place of administration is generally identified with the residence of the *trustee*;
- the trust’s residence is also deemed in the place where the principal business is carried out. If business is set in different countries, the principal business is identified with the criterion of the quantitative prevalence (eg, if the two properties are located in two different countries, the principal business is in the country where the most valuable property is).

The Italian Legislator provides two anti-tax avoidance presumptions for trusts to be considered fiscal

resident in Italy, even if none of the above conditions are met. In particular:

- the establishment of the trust took place in a black list country and at least one settlor and one beneficiary have the tax residence in Italy;
- after the establishment of the trust in a black list country, an Italian resident person brings properties into the trust.

In both the presumptions, income arising from the trust’s asset is added to the settlor’s or the beneficiary’s income and it becomes taxable in Italy.

The Italian direct taxation on trusts

The Hague Convention at article 19 allows the ratifying countries to apply the relevant provisions of their tax law, in relation to the trusts, without prejudice.

Therefore, in terms of taxation, even if the trust is regulated by a foreign law, the Italian tax rules are applicable.

With the 2007 Budget Law (Law no. 296 of 27 December 2006), indeed, trusts have been included among the taxable entities in Italy and, thus, they became to be subject to the Italian Corporate Income Tax (IRES).

In particular, the tax liability of trusts is regulated by the article 73 and ff. of the Italian Income Tax Code, which includes the “Trusts” among the entities classified as corporations for tax purposes.

The article 73 provides that trusts which meet the following criteria are liable to the Italian Corporate Income Tax (IRES):

- Trusts resident in Italy whose sole or main purposes is business activity (commercial entities);
- Trusts qualified Italian resident whose do not have as sole or main purposes business activity (no commercial entities);
- Trusts qualified not Italian resident, liable to taxation only for the Italian sourced income (non resident entities).

As a general rule, resident trusts are subject to corporate income tax, applying the IRES tax rate of 24% on their worldwide income.

Non-resident trusts are subject to tax only on their Italian sourced passive income and business income related to a permanent establishment in Italy through which they carry on a trade or business there.

Whether a taxpayer who qualifies tax resident in Italy is the beneficiary of the income derived from a trust, it is necessary to deeply analyze the three existing type of trusts regulated by our tax system:

- Trust where beneficiaries of income have been appointed (so-called “transparent trust”). If the beneficiaries of trust’s income are identified and named in the trust deed, the trust’s income is attributed to the beneficiaries regardless of its distribution for tax purposes and trust’s beneficiaries are taxed directly on their share of the trust’s income.
- Trust where beneficiaries of income have not been appointed (so-called “opaque trust”). The trust will be liable to the income taxation;
- Mixed trust (both transparent and opaque): the trust deed provides that a part of the trust income should be allocated as capital and another part will be distributed to the beneficiaries. In this case beneficiaries are liable to taxation only on the income distributed.

Finally, the Legislative decree no. 117/2017 approved a reform for non-profit entities (ETS),

which changed the previous regulation and provided some tax advantages for all those non-profit entities.

In order to benefit from the tax advantages, including the reduced taxable income calculated with different coefficients, the entity should have a public utility scope.

Taxation of distribution from “opaque” foreign trusts set up in black list countries

A Tax Decree issued in October 2019 (D.L. no. 124/2019) has changed the tax treatment of income generated by opaque foreign black-list trusts received by Italian residents. In particular, while distributions made out of capital will generally continue to be considered non-taxable, any distributions out of income generated by a foreign black-list trust will be taxed in the hands of the Italian residents who receive said income.

In particular, the abovementioned Tax Decree establishes that also distributions of income produced by “opaque” trusts – which means trusts with no identified beneficiaries – set up in black-list countries are subject to tax as capital income in the hands of the Italian residents who receive said income.

According to the Italian tax law, a country (other than EU member States and EEA countries which grant an effective information exchange) is considered black-list if the nominal tax rate is lower than 50% of the nominal tax rate applicable in Italy. To determine the nominal tax rate, it is necessary to take into consideration also special tax regimes that are capable of reducing the tax due through exemptions or reductions.

As a reminder, the nominal tax rate generally applicable to an opaque trust tax resident in Italy is the ordinary 24% corporation tax rate. However, a 26% tax rate may apply to financial income and, under certain conditions, a full exemption may apply to other sources of income (like gains on real estate, or pieces of art).

Capital distributions are not taxable in the hands of the Italian tax residents who receive said capital. However, the Tax Decree issued in October establishes that when it is not possible to determine if the distribution is made out of income or out of capital, the whole amount is deemed income distribution.

The new provisions entered into force on 27 October 2019.

In summary, distributions of income from trusts established in black-list countries will be subject to tax in the hands of the Italian tax residents who receive said income, disregarding the qualification of the trust as “opaque” or “transparent”. Furthermore, in case it is not possible to establish if the distribution is made out of income or out of capital, the whole amount will be considered as income.

The Italian indirect taxation on trusts

The Law no. 286 of 24 November 2006 re-introduced the gift and inheritance tax in Italy,

which was previously abolished in 2001.

According to that law, the inheritance and gift tax is calculated with regard to the degree of relationship between the settlor of the trust and the beneficiary and applying the current tax rates and allowances, as following described:

- 4% for the beneficiaries directly related to the settlor (eg. spouses, ascendants and descendants) with a no-tax allowance equal to 1,000,000 euro of asset transferred to each beneficiary;
- 6% for siblings of the settlor, with a no-tax allowance equal to 100,000 euro of asset transferred to each beneficiary;
- 6% for other relatives until the 4th grade and relatives in law in the direct line, as well as relatives in law in the collateral line until the 3th grade, without no-tax allowances;
- 8% for beneficiaries not related to the settlor on the full value of the asset transferred, without no-tax allowances.

A special provision is given by to Article 3, paragraph 4-ter, of the Italian Unique Code on Inheritance and Gift Tax (Legislative Decree no. 349/1990, as modified afterwards), which specifies that, as long as certain conditions are met, the transfer of enterprises, companies' participations or shares, if made in favour of the entrepreneur' spouse or his descendants, is fully tax-exempt.

The criteria required by the mentioned article are indeed the following:

- The individuals who receive the enterprise, the companies' participations or shares shall be the enterprenuer's spouse or his/her descendants;
- The recipients shall continue the business for at least 5 years from the transfer;
- In case of capital corporations, the receipients shall hold and keep the control of the company for at least 5 years.

Finally, with the introduction of the Law no. 112/2016 (so-called "*After us*" or "*Dopo di noi*"), a special treatment has been provided for people with a severe disability, whether certified by the competent authority.

If the trust – or any other legal structure – is settled in order to give assistance, with the trust fund, to disabled people, the transfer of funds is totally exempted from inheritance and gift tax.

The main controversies on Italian indirect taxation on trusts

It is appropriate to specify that inheritance and gifts tax applicable to trusts has not been a straightforward matter, especially with regards to the tax event when the inheritance or gift

tax is due.

There are two opposite jurisprudential approach about the tax event for indirect taxes on trusts:

- according to the first case law, the inheritance or gift tax shall be paid when tha asset is transferred to the trust. This orientation is supported by less recent Italian Supreme Court pronunciations (eg. sentence no. 4482/2016 and ordinances no. 3735/2015 and no. 3886/2015) and by the Italian Revenue Agency (eg. circulars no. 48/E/2007 and no. 3/E/2008). The approach results also more conventient for the taxpayer, since anticipating the tax event allows the trust to benefit from the current, and low, tax rates, avoiding the risk of a future increase;
- according with the second case law, inheritance and gift tax shall be paid when the asset is distributed to the beneficiaries and not when it is transferred to the trust. It is worth pointing out that the Italian Supreme Court strongly supports this thesis, especially in the latest case law decisions (eg. sentence no. 11401/2019, no. 19319/2019 and 1131/2019).

The concept of “interposed trust” in Italy

The Italian Legislator and the Italian tax authority are paying more attention during the last years to this type of structures, deeply analysing if they have been set up in order to obtain undue tax advantages, or whether if they have been established with the aim of pursuing the scope as indicated in the trust deed or if they have been created just to hide the asset to the Italian Revenue.

In order to prevent abusive transaction (including trusts), article 10-bis of Law no. 212/2000, enacted by Legislative Decree no. 128/2015, entitles the Revenue Agency to counteract tax advantages arisen from abusive transactions. The general anti-abuse rule applies when one or more transactions “lack any economic substance and, despite being formally in compliance with tax laws, are essentially aimed at obtaining undue tax advantages”. Transactions lack any economic substance when they consist of facts, acts and contracts that do not generate further economic effects other than the tax advantages.

Even if the trust is not established in order to obtain undue tax advantages, it could be considered as interposed when the settlor did not intend to dispose of his asset and retains complete control on it, even if it is formally transferred to the trustee. If the trust is deemed to be interposed, Italian tax authority does not recognize the trust. Consequently, income arising from trust assets is charged on the settlor according to the general rules for each specific income categories.

Disclosure obligations

The monitoring obligations are regulated in Italy by the Law Decree no. 167/90, pursuant to which Italian resident taxpayers are required to report any foreign investments and assets held abroad through a special form called “RW”.

The above obligation is addressed also to trusts, only if they qualify as non commercial trusts.

During the last years, the regulations on tax monitoring obligations have been subject to important changes, in accordance with the anti-money laundering law.

Therefore, according to the recent changes, the tax monitoring obligations in Italy have been extended to residents who are considered as beneficial owners of the investment, even if they are not the direct owners.

With Legislative Decree no. 90/2017 the definition of "beneficial owner" has been modified as it includes "*the natural person or persons, other than the customer, in the interest of whom or for whom, ultimately, the continuous relationship is established, the professional service is rendered or the transaction is performed*".

Specific provisions have been introduced for trusts, according to which the beneficial owner of the trust should now refer to the settlor, the trustee or trustees, the protector or another person on behalf of the trustee, the beneficiaries or class of beneficiaries, and any other natural person who exercises ultimate control over the assets conferred in the trust through direct or indirect ownership or through other means.

The Fifth EU Anti-Money Laundering Directive (2018/843), implemented in Italy through the Legislative Decree no. 125/2019, has further strengthened the disclosure obligation for the beneficial owners.