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## **Italian Taxation of Trusts**

Law 296 of December 27, 2006 (Budget Law 2007)

Circular 48/E of August 6, 2007

Effective Date: 1.1.2007

## General Requirements

- Hague Convention of July 1, 1985 (ratified in 1989)
- Effective transfer of assets to the trust/grantor loses control;
- Trustee has real powers of administration of the trust;
- Grantor may retain certain powers (appoint other beneficiaries, replace trustee);
- Power to revoke the transfer to the trust destroys the trust

## Grantor's Permitted Powers

- Act as trustee;
- Replace the trustee;
- Appoint beneficiaries (or assets or income of trust);
- Designate grantor as beneficiary of part of trust assets or income;
- Provide that assets return to grantor in certain situations outside the control of grantor.

## Tax Residency of Trusts

- Three alternative tests (to be met for at least 183 days in the tax year):
  - Legal seat (formal test: trust agreement controls);
  - Place of administration (facts and circumstances test: trust's administrative offices or trustee's domicile);
  - Place of principal activities (facts and circumstances test: location of assets or activities of the trust).

## Special Anti Abuse Rules

- A trust is presumed to be resident in Italy if:
  - It is formed in a nonqualified jurisdiction (no-white list country) and (at least) one grantor and one beneficiary are Italian resident persons;
  - An Italian resident person transfers Italian real estate to a trust;
  - Trust owns or controls an Italian entity and it is owned or controlled by Italian residents.

## Tax Classification of Trusts

- Fiscally non transparent trusts: no named beneficiaries of trust income, in the trust agreement or separately by trustee (trust income is attributed to the trust and tax is assessed upon and paid by the trust);
- Fiscally transparent trusts: income beneficiaries designated in the trust agreement or separately appointed by the trustee (income is attributed to the beneficiaries of the trust, and tax is assessed upon and paid by the beneficiaries of the trust);
- Hybrid trust: part of trust income is assigned to designated beneficiaries and part is retained by the trust;
- Commercial trusts vs. non-commercial trusts: principal activity test.

## Disregarded Trusts

- Trusts are disregarded for tax purposes when:
- Grantor (or beneficiary) can terminate the trust at will;
- Grantor can name himself or herself as beneficiary;
- Trustee cannot administer the trust without the consent of grantor;
- Grantor maintains substantial powers to administer the trust;
- Grantor can revoke the trust and assign trust assets to himself or herself or other beneficiaries;
- Beneficiary has the right to receive an anticipated distribution of trust assets during the life of the trust.

## Taxation of Trusts

- Trust computes and reports its income according to the rules that apply to corporations (separate entity approach).
- Fiscally non transparent trusts: trust income is attributed to and subject to corporate income tax upon the trust.
- Fiscally transparent trusts: trust income flows through passes and is taxed upon the income beneficiaries of the trust.
- Hybrid trusts: part of the income is subject to corporate income tax upon the trust and part of the income is attributed to and taxed upon trust's income beneficiaries.



## Taxation of Beneficiaries

- No tax on income beneficiaries upon distribution of trust's income (income is attributed to the beneficiaries when realized by the trust).
- One level of tax only: upon income beneficiaries or upon trust.
- Fiscally transparent trusts: income beneficiaries include their share of trust income as computed on the last day of trust's tax year.
- Fiscally non transparent trusts: tax is assessed on the trust, no tax on beneficiaries upon distribution of trust's income.
- Trust income is treated as income from capital subject to 12.5 withholding tax.

## Cross-Border Issues

- Resident trusts are taxed on worldwide income.
- Nonresident trusts are taxed on Italian-source income.
- Income from trusts is characterized as Italian-source income from capital (sheltered under tax treaties “other income” provision? Subject to Italian withholding tax? At what rate?)
- Nonresident beneficiary’s share of income of Italian business trust is Italian-source business income? Italian trust’s business income attributed to trust’s foreign beneficiary? Foreign beneficiary filing income tax return in Italy? Treaty relief if no PE in Italy? Tested at the level of trust/beneficiary?
- No tax on Italian trust’s distributions to foreign beneficiaries.

## Tax Treaty Issues

- Trust qualifies as “person” for treaty purposes.
- Fiscally nontransparent trust qualifies as person and treaty resident for tax treaty purposes.
- Fiscally transparent trust does not qualify as tax treaty resident (treaty benefits eligibility is tested at the level of the trust’s beneficiaries).
- Hybrid trusts: who get the treaty benefits: bifurcation approach.

## Gift Tax

- Transfers to trusts are subject to gift tax.
- Gift tax applies when beneficiary of trust assets is identified. Possibility of deferral?
- Tax rate (4-6-8 per cent) and exemptions vary depending on relatedness between grantor and beneficiary (one million euro exemption for close family members).
- Transfer of Italian assets to foreign trust is subject to gift or estate tax: beware!

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