

Italy: New Tax guidelines on Trusts Taxation

Italian Tax Authorities published Circular No. 34/E of 20 October 2022 after a long public consultation process. Circular No. 34/E significantly amends the interpretation of taxation of trusts and taxation of Italian beneficiaries as regards: income taxation, inheritance and donation tax and tax monitoring reporting obligations.

In this brief note we will only focus on some topics addressed by the Circular, mainly referring to foreign Opaque Trusts (benefitting of a low taxation) and related taxation of Italian beneficiaries and their tax monitoring reporting obligations.

A further relevant topic refers to the final recognition of the Supreme Court case law decisions, confirming the postponement of the application of the progressive donation tax only at the time of the final distribution to the beneficiaries and not at the initial endowment of assets from the settlor to the trust.

Warning & Actions

This is not a change of law but the official interpretation of an unclear tax provision introduced in 2019 on taxation of distributions made by foreign trustees (of foreign trusts subject to a low level of taxation) to Italian beneficiaries.

Foreign trustees should be aware that going forward they must provide sufficient evidence and reporting documentation in order to distinguish the “capital” endowed to the trust in respect to the “income” accrued during the life of the trust. Should this evidence not be available or sufficiently documented, under a legal presumption, the entire distribution amount would be deemed a taxable income for the Italian resident beneficiary and subject to the progressive income tax rate (up to 43%).

Under



Italian tax law, trusts are generally subject to different tax regimes depending on whether the beneficiaries are clearly identified (or not) and have an actual right to claim from the trustee the distribution of income and/or capital: “*transparent trusts*” versus “*opaque trusts*”.

1. *Foreign Opaque Trusts subject to low taxation:*

Generally, a foreign opaque trust is taxable in Italy only for income produced in Italy and distributions to Italian beneficiaries are not taxable in the hands of the beneficiary.

However, if for any reason the trust’s income is subject - in the Country of tax residence of the Trust - to a level of taxation less than half of that applicable in Italy (ie. less than 12% of effective taxation, in the case of commercial trusts, or 13% in the case of non-commercial trusts), distributions of income by the trustee to the Italian tax resident beneficiary are subject to taxation in the hands of the same beneficiary as “capital income” (*reddito di capitale*) on cash basis.

As a result, the reduced level of taxation of the foreign trust implies a consequent taxation of the resident beneficiary for the income generated by the trust.

The Circular clarifies a tax law provision introduced in 2019 and so far, quite unclear in its practical interpretation; the purpose of this provision was intended to hit trust structures located in Countries where the effective trust’s taxation is significantly lower than the equivalent Italian taxation.

We need to point out that several foreign trusts for many reasons are included in this category of trusts.

1.1 Trustee’ obligations and the “legal presumption of income” distribution

Funds distributed by a Foreign Opaque Trust (subject to a low level taxation) to Italian beneficiaries are always qualified as “taxable income”, other than when the trustee provides suitable grounds to distinguish the “capital component” in respect to the “income’s one”.

Indeed, a preliminary distinction should be made between:

- “assets/capital”: consisting of any capital or asset endowment made by the settlor (or by any third party) to the trust, and
- “accrued income”: consisting of any income accrued to the trust during its life, including any income reinvested or capitalized by the trustee.

On the basis of the above legal presumption, introduced in 2019, when it is not possible to clearly distinguish between income and capital, the entire amount received by the Italian beneficiary from the trustee of a non-commercial trust must be qualified as an “income distribution” and consequently



entirely subject to tax in the hands of the beneficiary at its progressive income tax rate (IRPEF tax rate up to 43%).

The only way for the beneficiary to limit the Italian taxation to the component of funds distribution representing the actual “income” component accrued by the trusts, is to obtain by the trustee clear evidence supporting the nature of the income, supplying appropriate accounting records and other documents e.g. bank statements, financial statements (better if audited), registered deeds of the original settlor’ endowment, etc..

In the light of these recent clarifications, foreign trustees of trust having Italian beneficiaries, should consider to set up more detailed accounting reporting to satisfy this tax provision, as well as future requests of Italian trust beneficiaries, aimed to limit the Italian taxation at the time of funds distributions.

2. Taxation of assignment of assets/funds to the trust

Circular No. 34/E also clarified that both the deed of establishment of a trust and the subsequent endowment of assets to the trust are subject to a fixed registration tax equal to Euro 200, each.

Indeed, they do not represent an actual transfer of wealth from the settlor to the trustee, as they are only acts aimed at managing assets under a fiduciary agreement regulated by the deed of trust.

This interpretation is finally compliant with the Supreme Court case law decisions and represents a new approach of the Tax Authorities that up to date have always alleged (also in court) the immediate application of the inheritance and donation tax.

The Circular clarifies that the inheritance and donation tax is usually due only when the trustee distributes assets to the Italian beneficiaries at the progressive tax rate (variable between 4% and 8% in relation to the relationship existing between the settlor and the beneficiaries).

However, if the settlor is resident in Italy or the assets are in Italy, the deed of endowment of assets to the trust should be registered with the Italian tax office within 20 days (60 days if the deed is executed abroad).

The registration of the deed would be also relevant to give evidence, at the time of funds distributions, of the amount of the “capital” component not subject to income tax but only to donation tax.

Should the trustee resolve an assets distribution without formalities, also the Italian beneficiary shall be required to register the distribution event and liquidate the inheritance and donation tax only on



the “capital” component of the distribution, to the extent that such component is sufficiently documented by the trustee.

3. Tax monitoring obligations

Pursuant to AML provisions, the reporting and compliance obligations are required not only from the owner of a foreign investment but also from the “ultimate beneficial” (UBO) of the assets.

The definition of “beneficial owner”, introduced by the 2017 reform (implementing the IV Anti Money Laundering Directive), is broader than in the past and no longer requires a percentage of allocation of assets or control of the legal entity. With regards to trusts, the UBO definition includes those individuals who ultimately benefit from the activities of the trust.

In this respect, beneficial owners of a Foreign Opaque trust are the Italian resident beneficial owners who are identified or easily identifiable, even indirectly, under the trust deed provisions or related documents, including those identified by "classes" of individuals (eg. settlor's legal heirs, settlor's children, etc.).

Hence the obligation for the beneficiary of “discretionary” trusts to disclose in the RW form of their tax return the investments held abroad by the trust apply only to the extent that the beneficiary has an actual right to claim from the trustee the assignment of income or capital on the basis of the deed of trust or following a trustee resolution of distribution.

On the other side, beneficiaries of a “non-discretionary” trust must always report the value of foreign investments held by the trust, and the percentage of assets in the trust.

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