



Circular Letter 20 October 2022, No. 34/E

ITALIAN REVENUE AGENCY ISSUES GUIDELINES ON THE TAXATION OF TRUSTS

On 20 October 2022, the Italian Revenue Agency issued Circular Letter No. 34/E/2022 (the “**Circular**”) laying down comprehensive guidelines on the tax treatment of trusts and similar entities for tax purposes.

1. Inheritance and gift tax (“IHGT”)

Change of interpretation regarding the moment when IHGT is due

According to the Italian Revenue Agency, a trust can be qualified as a “progressive” gift for IHGT purposes. In the past the Italian Revenue Agency held that the taxable event for IHGT purposes was triggered at the time of addition of the assets into a trust.

By contrast, the Supreme Court case law took the opposite view that IHGT has to be levied at the time of the final distribution of capital to the beneficiaries.

In the Circular, the Italian Revenue Agency aligns its interpretation to the Supreme Court’s case law. In particular, it is confirmed that:

- i. the addition of assets into trusts represents a non-taxable event for IHGT purposes;
- ii. IHGT is applied only upon the enrichment of the beneficiary which occurs (a) upon distribution of the capital to the beneficiaries or earlier (b) in case of beneficiaries acquiring a vested interest over the trust’s assets.

The case under (ii) above applies only with reference to distributions of capital. Distributions of income are not instead subject to IHGT but rather, possibly, to income tax if the trust is not established in a low-tax jurisdiction, as better specified below.

Effects of change of interpretation on existing trusts

For (past) cases where IHGT had already been paid upon addition of assets (i.e., in line with the previous position of the Italian Revenue Agency), the Circular indicates that no additional IHGT is due upon the final distribution to the beneficiaries, provided that the transferred assets and the beneficiaries have not changed. Otherwise, IHGT paid upon the addition would be offset against any higher IHGT liability arising upon the final distribution.

Alternatively, the Circular also contemplates the possibility to request a refund for the IHGT (unduly) paid, in case the statute of limitations has not elapsed.

Determination of IHGT due

In general, IHGT is levied on the worldwide assets transferred by a resident transferor and on the Italian-situs assets transferred by a non-resident transferor. Subject to a number of exceptions, different proportional rates (from 4% to 8%) and exemption thresholds (up to € 1,000,000) apply depending on the degree of kinship between the transferor and the transferee. In the case of trusts, the Circular clarifies that:

- (i) the applicability of IHGT is verified, from the territoriality point of view, on the basis of the settlor's Italian residence or location of assets in Italy, to be assessed at the time of the addition of assets into the trust; while
- (ii) the applicable IHGT rates and exemption thresholds, as well as the taxable base, are determined on the basis of the family relationship between the settlor and the beneficiary existing at the time of the distributions to the beneficiaries.

IHGT implications for disregarded trusts

The Circular contains important clarifications on the IHGT treatment of trusts that are qualified as disregarded for Italian income tax purposes. Changing its previous interpretation, the Italian Revenue Agency indicates that, for such types of trusts, the look-through approach shall be adopted not only for income tax purposes, but also for IGHT purposes, with the consequence that assets held by a disregarded trust are included within the taxable estate of the settlor upon the settlor's demise.

2. Income taxation

The new rules on taxation of income distributions from low-tax trusts

The Circular provides guidelines on a provision introduced in 2019 that subjects to progressive taxation (up to 43% plus surcharges) distributions of income from opaque trusts established in low-tax jurisdictions in favour of Italian resident beneficiaries. The law also provides that, lacking adequate evidence on the capital component of the distribution, the entire amount is considered income.

According to the Italian Revenue Agency:

- i. a jurisdiction qualifies as "low-tax" if the nominal tax rate applied to the income of the trust is lower than 50% of the nominal Italian income tax rate (i.e., generally 24% or 26% depending on the type of income);
- ii. the provision should apply also to distributions out of trusts established in EU/EEA States if they benefit from special exemption regimes in their State of residence (contrasting with the wording of the relevant provision that instead seems to exclude from its scope distributions out of trusts established in EU/EEA States);
- iii. if the distributions include income sourced in Italy and already subject to taxation therein, that portion of income will not be taxed again in the hands of resident beneficiaries;
- iv. taxpayers are not allowed to submit an advance ruling to demonstrate that the trust has not the effect of shifting income to a low-tax jurisdiction.

Moreover, with regards to the distinction between the capital and income component of the distribution, the Circular clarifies that:

- i. capital is represented (only) by the initial or subsequent additions by the settlor (or third parties);
- ii. income is represented by any proceed realized by the trust, including capitalized income and gains;

- iii. the (taxable) income needs to be redetermined following Italian tax rules;
- iv. both accounting and non-accounting documents (e.g., bank or financial statements) can constitute evidence that the trust has distributed capital rather than income.

The case of "commercial" trusts

Finally, the Circular addresses the case of resident commercial trusts (i.e., trusts having as their exclusive or principal object the carry out of commercial activities), clarifying that such trusts are subject to an income tax regime patterned to that applicable to corporations (including the application of the participation exemption regime on qualifying shareholdings), so that distributions out of commercial trusts are subject to withholding tax at the rate of 26% (the rate applying to dividends) to be applied by the trust as Italian withholding agent.

3. Tax reporting of foreign financial assets

According to the Circular, resident beneficiaries of foreign trusts, even if identified by "classes" (e.g., the settlor's legal heirs), are subject to reporting obligations as beneficial owners of the foreign trust's assets. That said, the Circular provides for a distinction between beneficiaries of "non-discretionary" and "discretionary" trusts, the latter being subject to reporting obligations only on the basis of the information available to them (if, for example, the trustee notifies the decision to distribute income and/or capital). Subsequent beneficiaries (i.e. those who will become beneficiaries upon the demise of the first beneficiary) are confirmed not to be subject to reporting obligations unless they may be entitled to distributions prior to the first beneficiary under the trust deed and related documents.

Moreover, the Circular confirms that settlors, trustees and protectors are not subject to reporting obligations.

4. Quasi-wealth taxes

Lastly, the Circular elaborates on the treatment of trusts in relation to quasi-wealth taxes on foreign financial assets (so called IVAFE) and real estate (so called IVIE).

First it is clarified that starting from tax year 2020, Italian resident trusts qualify as taxable persons for both IVAFE and IVIE purposes. Moreover, the Circular takes the view that Italian tax resident beneficiaries of opaque trusts should not be subject to IVAFE and IVIE in relation to the trust assets, considering that they do not hold a legal title over the relevant assets.

5. The impact of the Circular on the Forfait Tax Regime

The Circular does not affect the position of "new residents" taxpayers enjoying the so-called Forfait Tax Regime given that the central tax office dealing with that regime has developed a well-established practice according to which distributions from both disregarded and non-disregarded foreign trusts (even if established in low-tax jurisdictions) are sheltered by the substitute tax for income and IHGT purposes.

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