INTERNATIONAL TRUST PLANNING *with* ITALY

Facts

- A number of wealthy U.S. and Latin-American families own - or plan to acquire in the future - assets and properties located in Italy.

- A number of wealthy U.S. and Latin-American families have one or more of their members currently living in - or anticipating a future relocation to - Italy.

- Trusts are a key component in the international estate plans of many U.S. high-net-worth families and individuals. Trusts are increasingly becoming a key component in the international estate plans of many high-net-worth Latin-American families and individuals.

- Trusts are legal instruments that do not belong to the Italian *civil law* legal system; however, Italy was one of the first European countries to ratify the 1985 Hague Convention on the Recognition of Foreign Trusts. Therefore, certain specific foreign trusts – if properly structured and governed by foreign (e.g., U.S., U.K., etc.) law – can have valid legal effects in Italy and be recognized by Italian courts.

- Italy has never enacted so far any domestic civil and commercial legislation specifically regulating trusts and their use; tax authorities, practitioners, doctrine and jurisprudence often do not share the same conclusions and opinions.

- Italy has recently enacted the first domestic income tax rules applicable to trusts. These new provisions became effective on January 1, 2007.

- Trusts have become increasingly popular within the Italian legal and business system, and they are used for a variety of purposes.

Important developments

There have been recent important developments in Italy with regard to the taxation of trusts. Notwithstanding the ratification of the Hague Convention on trusts in 1989,[1] previously Italy had not enacted specific domestic tax legislation regulating trusts and their operation. Now, with Law n. 296 of 27 December 2006 (the "2007 Budget Law"), Italy has finally enacted the first income tax rules applicable to trusts. These new provisions became effective on January 1, 2007.

[1] Law 10/16/1989 n. 364. Notably, the tax regime applicable to foreign trusts is remanded by Art. 19 of the Convention to the fiscal autonomy and competence of the individual ratifying States (Art. 19: "Nothing in the Convention shall prejudice the powers of States in fiscal matters").

Trusts are not legal instruments belonging to the Italian *civil law* tradition and legal system, and to date they have not been regulated by specific Italian civil or commercial law. However, following Italy's ratification of the Hague Convention of July 1st, 1985 on the law applicable to trusts and on their recognition, Italy recognizes that specific trusts subject to foreign governing law may produce valid legal effects within the Italian legal system. Unfortunately, the mixture of the Anglo-Saxon *common law* concept of trusts and the rigid and formalistic system based on codified *civil law* has led to many problems that have been widely debated, with alternate outcomes, by practitioners, commentators, courts, tax agencies, and legal scholars. In such regulatory scenario, differing opinions usually have coexisted, and the solution to a specific legal question involving trusts and their effects in Italy generally needs to be sought in the correct systematic interpretation of the general principles of the Italian legal and fiscal system.

The tax regulation of foreign trusts has been another "grey area" of Italian law due to the complete absence, until December 2006, of specific tax legislation. Italy, indeed, was for some time some kind of a "tax haven" for trusts, since a lack of official guidance as to how they should have been taxed often led to very low or virtually zero taxation. Now, some of these concerns have been somewhat clarified by the 2007 Budget Law, albeit still outside the scope of a clear and comprehensive regulation. In the absence of a clear and comprehensive regulation by law, the tax regime applicable to trusts has been - and, in a certain way, still is today - generally deduced by interpretation of sporadic case law, reliance on guidelines offered by opinions of the Italian tax authorities, and interpretation of the general principles of the Italian fiscal system. As a result, the tax treatment of trusts is not uniform and far from clear. Several theories have been proposed, depending on the specific types of trusts and their overall purposes; on the basis of these theories, different legal authorities have proposed different results for the taxation of trusts and their beneficiaries.

The 2007 Budget Law has now included both resident and non-resident trusts within the scope of the application of the Italian corporate income tax (IRES). The new law simply refers to "trusts" in general, and does not make any reference to or provide different tax treatment for different types of trusts. As a general rule, for purposes of the Italian corporate income tax, a trust is now generally considered an autonomous taxable entity, separate from the settlor, the trustee and the beneficiaries.

Notably, the 2007 Budget Law has introduced the following important changes:

(i) Trusts with identified beneficiaries will be treated as fiscally transparent entities. Therefore, any beneficiary who is identified as such in the underlying trust instrument, under any form of trust (e.g., discretionary, fixed, revocable, irrevocable, etc.), will be taxed on the income of that trust that will be attributed to him/her (i.e., the beneficiary will be taxed as a result of his/her entitlement, irrespective of any actual distribution). On the other hand, if a trust has no identified beneficiaries, the income originated by the trust will be determined and taxed in the hands of the trust according to the ordinary applicable rules;

(ii) If a trust is established in a jurisdiction not included in the Italian published "white list" (i.e., a jurisdiction that does not allow a sufficient exchange of information, as listed by the Ministerial Decree of September 4, 1996) and the

settlor is Italian resident and one or more of the beneficiaries is/are Italian resident, the Italian Tax Authorities will presume that the trust is resident in Italy and will be liable to tax in Italy (this presumption may be rebutted with proper advice); and

(iii) If a trust is established by an Italian resident in a "non white list jurisdiction" and - regardless of the residence of the beneficiaries, who may not have an Italian connection - holds Italian-*sitused* real estate, the trust will be presumed to be resident in Italy (currently it is not entirely clear if this presumption may be rebutted).

The identification of trusts as IRES taxable entities has as an immediate effect the obligation for them to keep bookkeeping records; in addition, trusts will be subject to the monitoring obligations laid down by EC Directive 2003/48/CE on capital gains paid to non resident persons.

Provided that in Italy the fiscal regulation of trusts is brand new and certainly not comprehensive, we expect that the Italian Tax Authorities will release additional pertinent clarifications and guidance in the near future. However, at the present time - after the enactment of these new tax provisions - attention should always be paid (i.e., need for careful trust planning and related drafting) for the possible tax consequences resulting from the application of the new – and currently not particularly clear – provisions of Law n. 296 of December 27, 2006.

Conclusions

- For wealthy families with assets, properties and family members located and/or living in - or relocating to Italy - opportunities are available to make use and take advantage of international trust planning.

- Wealthy families and their legal/tax advisors should always seek specialized Italian legal/tax advice at the early stage of any international trust planning for Italian-based assets and/or with Italian-resident beneficiaries.

- Existing trusts need to be carefully reviewed and, where needed and possible, revised to comply with the new Italian income tax rules applicable to trusts.

- With proper structuring, planning and drafting substantial benefits may be achieved and effective and compliant strategies for international tax minimization, wealth preservation and intergenerational succession implemented.

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