



Italy: New rules on the taxation in Italy of foreign trusts

Tax Alert

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At the end of last year, Italy introduced two new income tax rules for foreign trusts⁽¹⁾.

Rule 1

The capital income referred to in article 44(1)(g-sexies) of Presidential Decree no. 917/1986 (the Italian Income Tax Code or 'IITC') now includes "*income **distributed**⁽²⁾ to residents of Italy by trusts and trust-like institutions, established in countries and territories that, with reference to the treatment of trust income, are deemed to be tax havens as defined in article 47-bis, even when the resident payees cannot be considered as the identified trust beneficiaries indicated in article 73*".

Previously, the IITC had not regulated the taxation of **distributions by foreign discretionary trusts** to residents of Italy. This gap in legislation was further complicated by Revenue Agency Circular no. 61/E of 27 December 2010 (the 'Circular'), which, in commenting on the **allocation of income**, made reference, in the second paragraph below, to discretionary trusts, even though these were not mentioned in the IITC tax rule itself:

- "*the **allocation of income** by a trust to resident beneficiaries is taxable in Italy in the hands of those beneficiaries as capital income, whether or not the trust is resident in Italy and whether or not the income has been produced in Italy. Obviously, as mentioned above, if the income allocated to resident beneficiaries has been produced by the trust in Italy and already taxed there under article 73 IITC, it will not be subject to further tax in the hands of the beneficiaries;*
- *this [tax] regime prevents undue tax savings that could be made, for example, in the case of **discretionary trusts established in foreign tax havens**. In such cases, the lower taxation of the trust would be offset, in any event, by the taxation of the resident beneficiary [on capital income] in accordance with the oft-cited article 44(1)(g-sexies) IITC*".

(1) On 24 December 2019, Law no. 157/2019 was published in the Official Gazette, converting Law Decree no. 124 of 26 October 2019 into law. This law decree, which introduced 'urgent and undelayable tax measures', also included new rules on the taxation of foreign trusts, in article 13.

(2) All added emphasis in this Tax Alert is ours.

Under the new rule, income **distributed** to resident beneficiaries by discretionary trusts located in tax havens will be taxed on a cash basis (and therefore – breaking with the past practice established in the Circular – not on an accruals basis). Indeed, the Revenue Agency’s position on the taxation of discretionary foreign trusts, as expressed in the Circular, would seem to be implicitly contradicted by the current legislators, who now comment on the scope of application of article 44(1)(g-sexies) ITC as follows: “ *Given the literal reference [in the previous version of article 44(1)(g-sexies)] to ‘allocated income’, the old provisions on direct taxation can certainly apply to ‘identified beneficiaries’ of foreign ‘non-discretionary’ trusts while it is harder to include foreign ‘discretionary’ trusts (i.e. trusts whose beneficiaries may receive the trust income, or part of it, only after a decision taken at the discretion of the trustee) within their scope of application*”⁽³⁾.

Since there is now a clear distinction between the treatment of discretionary and non-discretionary trusts, it would seem, based on the literal wording of the new rule, that distributions of income to resident beneficiaries by discretionary trusts can be taxed in Italy, under article 44(1)(g-sexies) ITC, **only if the trust is established in a tax haven** as defined in article 47-bis.

Rule 2

The second new rule⁽⁴⁾ reads as follows.

“If, in relation to distributions by foreign trusts, or by trust-like institutions, to beneficiaries resident in Italy, it is not possible to distinguish between distributions of income and distributions of principal, the entire amount shall be treated as income”.

The legislators have clarified⁽⁵⁾ that this new provision is meant to “ *resolve the issue of distributions by ‘discretionary’ foreign trusts, in relation to which Italian beneficiaries often say that they are unable to distinguish between the part that is a distribution of principal and the part that is a distribution of income. For this purpose, the provision stipulates that when it is impossible to make this distinction, distributions by foreign trusts must be treated in full as income if they might give rise to taxable income as defined in article 44(g-sexies)*”.

(3) In the explanatory report accompanying Law Decree no. 124/2019.

(4) Introduced by adding paragraph 4-quater to article 45 ITC.

(5) In the explanatory report accompanying Law Decree no. 124/2019.

It follows that the assumption that a distribution is taxable can be rebutted by providing the Italian Revenue Agency with proof that the distribution has been made from the ‘principal portion’ of the trust, leaving only the ‘income portion’ taxable.

Points to be clarified

- The date on which the new rules will come into force⁽⁶⁾.
- How article 47-bis ITC should be applied in relation to foreign trusts⁽⁷⁾.
- What type of proof of the distinction between a distribution of principal and a distribution of income has to be given to the Revenue Agency.
- Confirmation that distributions by trusts other than those located in ‘tax havens’ as defined in article 47-bis are not taxable.

Given the numerous uncertainties surrounding the legal framework described in this Tax Alert, clarifications from the Revenue Agency are awaited, also in view of the new rules introduced by Law Decree no. 124 of 26 October 2019.

(6) As it is unclear whether the new rules interpret existing ones or introduce new provisions, it is also unclear whether they apply retroactively or, instead, to distributions of income made by foreign trusts from financial year 2020 onwards.

(7) Article 47-bis, identified by article 13 as the rule to be applied in determining whether or not a trust is located in a tax haven, was not intended to apply specifically to trusts. Mere reference to this rule, without further clarification, leaves room for different interpretations.

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