



COMPARATIVE AND INTERNATIONAL TAXATION

TAX SYSTEMS OF UK AND ITALY: A COMPARATIVE ANALYSIS

INTERNATIONAL FISCAL ASSOCIATION:
BILATERAL MEETING
OF THE UK AND ITALIAN BRANCHES
FLORENCE 2001



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Income Taxation of Trusts from an Italian Perspective

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1. Introduction

The Convention on the law applicable to trusts and on their recognition, signed at The Hague on July 1, 1985, has been ratified by Italy by the law October 16, 1989, no. 364. The Convention came into force on the 1st of January 1992.

This date can be considered as a term of reference in the calculation of the time with regard to the Italian studies published on trusts, so that we could classify them as «b.C.» (before the Convention) or «a.C.» (after the Convention).

To give you just an idea about this phenomenon, thus confirming my accounting background, b.C. in Italy only seven monographs were published, the first one in 1935¹, the sixth in 1971² and, after a silence of twenty years, the seventh in 1991³. In the same period (from 1936 to 1991) the inventory of the Italian articles and other studies gives a total of 23, of which just one regarding the fiscal aspects of trusts (written by 15 authors of which just 2 are Italians)⁴.

The situation dramatically changes a.C.: as of December 31, 2000, the monographs published account to 19, and the articles and other writings to about 200⁵.

This gives evidence of the increasing interest in the study of trusts in Italy, both at academic and at professional and practical level.

The reason of that could be explained not only stressing the growing attention to the globalisation forces, that affect also the domain of the laws, but also, in my opinion, focusing on the theory of the Italian «internal trusts», whose father is prof. M. Lupoi⁶.

The Italian «internal trust» is a trust which the most important elements are lo-

¹ See R. Franceschelli, *Il trust nel diritto inglese*, Padua, 1935.

² See M. Lupoi, *Appunti sulla real property e sul trust nel diritto inglese*, Milan, 1971.

³ See AA.VV., *Fiducia, trust, mandato ed agency*, Milan, 1991.

⁴ See AA.VV., «The Treatment of Trust under the Oecd Model Convention», *Dir. prat. trib.*, 1989, I, at 1520 et seq. The two Italian authors are Victor Uckmar and Guglielmo Maisto.

⁵ For the inventory see «Bibliografia degli scritti italiani sui trusts», in *Trusts e attività fiduciarie*, 2001, at 155 et seq.

⁶ See M. Lupoi, *Trusts*, Milan, 1st ed. 1996; 2nd ed. 2001; Id., *Introduzione ai trusts. Diritto inglese, Convenzione dell'Aja, diritto italiano*, Milan, 1994, as well as many other writings.

cated in Italy: in other words, it is a trust in which the settlor is Italian and the assets of the trust fund are located in Italy. The constant is that the law applicable to the trust is always foreign, since Italy has no laws regarding trusts⁷, while the residences of the trustee and of the beneficiaries, if any, can be in Italy or abroad⁸.

This theory has been widely accepted both at academic level and at professional and practical level, as well by the Courts and by the various public Authorities (Real Estate Register, Company Register, Tax Administration, etc.). As of today, many trusts have been settled and registered in Italy: family trusts, business trusts, charitable trusts, and so on, owning company shares, real estates, and any other kind of assets⁹.

That means that today Italian professionals have the great opportunity to utilise the «tool» of trusts, which in many cases provide a more flexible and efficient solution to many problems than the traditional civil law «tools» of the Italian law.

As far as the fiscal aspects of trusts are concerned, a general remark needs to be addressed: the Italian tax laws have no specific rule regarding trusts, so that the tax treatment of trusts has to be identified by way of interpretation of the existing tax rules and principles¹⁰.

In the following pages of this paper, I indicate the results of such effort of interpretation, trying to draft the tax treatment of trusts from an Italian perspective¹¹. I indicate in the notes the different opinions and the arguments in favour or against them.

2. General remarks on the income taxation of trusts

As far as income tax is concerned, the first topic to be discussed is the identification of the person liable to tax with regard to the income arising from the trust assets: is it the settlor, the trustee, the beneficiary, or the trust itself, qualified for tax purposes as a «person»?

The answer to that question is very important, since it will allow us to focus on the problems of the fiscal residence of the trust, to qualify the income within the categories (schedules) provided for by the income tax law, to choose the proper rules regarding the calculation of the income, and so on.

⁷ There are some projects of laws pending in Parliament, regarding trusts in some ways.

⁸ See M. Lupoi, *Trusts*, 2001, already quoted, at 546 et seq.

⁹ For references see M. Lupoi, *Trusts*, 2001, already quoted, at 551 et seq.

¹⁰ In some instances, it is necessary «to force», in some way, the traditional interpretation of certain rules, due to the specific characters of a legal phenomenon like trusts. The reason is obvious: the Italian tax system has been drafted for a civil law environment, and the opinions and interpretations of the scholars and of the Courts with regard to the tax law rules is consistent with such an approach. But trusts, in many cases, have so peculiar characters that cannot be afforded, in a systematic way, without catching their rationale and trying to translate them in the interpretation of the tax rules.

¹¹ For an analysis of the arguments which could be considered the rationale of the results of that interpretation process see, if you like, S. Marchese, «Trust e imposizione sul reddito: alcune riflessioni», in *Trusts e attività fiduciarie*, 2001, at 5 et seq.

Art 1 of the Italian Income Tax Code (ITC) provides that the person that has the «possess of income» is liable to tax. The common interpretation of such quite unusual expression is that the owner of the source of the income is the person liable to tax.

One answer to the question above mentioned could be: since the trustee has the ownership of the trust assets, and since a trust, generally speaking, is not a legal person according to the civil and common law, then the person liable to tax is the trustee¹².

That solution would imply that the trustee has to add to his¹³ personal income the revenues and expenses of the trust, and that the trust income is taxed according to the tax position of the trustee: for instance, if the trustee is an individual, the marginal tax rate applicable to the trust income will depend on the total income of the trustee; if the trustee is a trust company showing a loss, that will be deducted from the income with a reduced or no taxation, and so on.

We cannot agree on such an interpretation: it is true that the trustee has the ownership of the trust fund but, on the other hand, he is not entitled to use the income arising from the trust fund for purposes which are not consistent with the equitable obligation that he has as a trustee. In other words, he – as a person – has no ability to pay taxes on the trust income.

As a consequence, generally speaking the proper solution to the problem of the identification of the person liable to tax with regard to the trust income is to consider the trust itself, for fiscal purposes, as a «person» subject to corporation tax¹⁴.

¹² See A. Fedele, «Visione d'insieme della problematica interna», in AA.VV., *I trusts in Italia oggi*, Milan, 1996, at 269 and seq. and spec. at 273; R. Schiavolin, «I soggetti passivi», in AA.VV., *Imposta sul reddito delle persone giuridiche. Imposta locale sui redditi*, Turin, 1996, at 71; F. Gallo, «Trusts, interposizione ed elusione fiscale», in AA.VV., *I trusts in Italia oggi*, already quoted, at 289 and seq. and at 293 and seq., also published in *Rass. trib.*, 1996, at 1043 and seq.; G. Marino, *La residenza fiscale del trust*, in *Trusts e attività fiduciarie*, 2000, at 72 and seq.; Id., *La residenza nel diritto tributario*, Padua, 1999, at 164 and seq.; A. Giovannini, *Soggettività tributaria e fattispecie impositiva*, Padua, 1996, at 422 et seq.; Serbini, «Appunti sul trust e sui riflessi fiscali conseguenti al suo riconoscimento», *il fisco*, 1994, at 7969 and seq.; R. Dominici, «Il trust nell'ordinamento tributario italiano», presentation at the Meeting «Il trust anglosassone e l'attività fiduciaria italiana», Milan, April 1995; G. Palumbo, «Profili tributari dei «common law trusts»», *Riv. dir. trib.*, 1995, I, at 195 and seq.; Id., «Pianificazione fiscale dei trusts alla luce della giurisprudenza italiana e svizzera», *il fisco*, 1999, at 11655 and seq.; F. Paparella, «Trust ed interposizione fittizia di persona nella disciplina della imposte dirette», *il fisco*, 1996, at 4812; J.F. Avery Jones *et alii*, «The Treatment of Trusts under the Oecd Model Convention», *Dir. prat. trib.*, 1989, I, at 1521 and seq. and spec. at 1526; V. Ficari, «Il trust nelle imposte dirette (IRPEG ed IRAP): un articolato modulo contrattuale oppure un autonomo soggetto passivo?», *Boll. trib.*, 2000, at 1529.

¹³ Or her or its; in the following of this writing the use of «he or his» will include also the other pronouns.

¹⁴ See G. Puoti, «La tassazione dei redditi del trust», in AA.VV., *I trusts in Italia oggi*, already quoted, at 321 and seq. and spec. at 324 and seq.; D. Cherubini, V. Delmonaco, *I trusts*, Rome, 1999, at 119 and seq.; L. Perrone, «La residenza del trust», presentation at the 1st Congress of the Association «Il Trust in Italia», November 1999, in *Rass. trib.*, 1999, at 1601 and seq.; Ministry of Finance, Servizio centrale degli ispettori tributari, «Resolution May 11, 1998, no. 37», *Guida normativa*, October 6, 1998, at 13 and seq.; F. Merli, F. Mori, F. Tempestini, «Sale and lease back», in AA.VV., *I trusts in Italia oggi*, already quoted, at 389 and seq. and spec. at 392; M. Miccinesi, «Il reddito del trust nelle varie tipologie», *Trusts e att. fiduciarie*, 2000, at 309 and seq.; L. De Angelis, «Trust e fiducia nell'ordina-

The above statement needs to be clarified.

It is well known that the best scholars have pointed out that it is misleading to study the «trust» in an unitary way, but it is necessary to consider the different types of «trusts», classifying them in a way consistent with the purposes of the study¹⁵. That implies a different tax treatment of trusts, depending on their characters¹⁶.

3. Trusts as «persons» for fiscal purposes

Among the «persons liable to corporation tax», Article 87 ITC includes corporations, other legal persons, associations, and other organisations, not belonging to other persons liable to tax, which show the «possession of income» in an «unitary and autonomous way».

Can a trust be qualified as a person liable to corporation tax?

The answer is yes.

The requirements provided for by the rule above indicated are:

i. the «non belonging» of the trust assets to other persons subject to tax: this requirement can be easily identified in the rule of the Hague Convention, according to which in a trust «the assets constitute a separate fund and are not a part of the trustee's own estate»¹⁷; on the other hand, such assets are not a part neither of the settlor's own estate, since he has transferred them to the trustee, nor of beneficiaries' estate, since their interest is toward the trustee, and they do not have any interest or estate in the trust property;

ii. the existence of an «organisation»: this requirement can be identified in the administration and management function of the trustee, with regard to the trust fund or to his power to identify the beneficiaries in a discretionary trust;

iii. the unitary and autonomous way in which the income arises: this requirement is currently seen as a consequence of two above mentioned: the existence of an organization, that does not belong to other taxpayers, implies the autonomy of the income, which is no more that the result of the autonomy of such organization, seen as a taxable entity¹⁸.

mento italiano», in V. Uckmar (ed.), *Corso di diritto tributario internazionale*, Padua, 1999, at 459 and seq. and spec. at 474; F. Tundo, «Implicazioni di diritto tributario connesse al riconoscimento del «trust»», *Dir. prat. trib.*, 1993, I, at 1295 and seq.; G. Maisto, «Italy», in «The Taxation of Trusts in Civil Law Countries», *European Taxation*, 1998, at 246; A. Stesuri, «Il trust come strumento di pianificazione fiscale», *Corr. trib.*, 1998, at 3272 et seq.; F. Greco, «Trust e tax planning», *il fisco*, 1999, at 9391 and seq.; Id., «Note sulla determinazione della residenza fiscale del trust», *ibidem*, 1998, at 11535 and seq.

¹⁵ See M. Lupoi, *Trusts*, 2001, already quoted, *passim*, but spec. at 7 and seq.

¹⁶ See M. Lupoi, *Trusts*, 2001, already quoted, at 791 et seq.

¹⁷ See Article 2, a), of The Hague Convention on Trusts, already quoted.

¹⁸ In the Italian tax system the circumstance that a trust has one or more trustees seems without consequences for the purpose to qualify it as a taxable person; thus, there is no need to consider it as a

All trusts, including bare trusts, should be treated, for fiscal purposes, as persons. But this fact does not imply that the rules of taxation are the same for all types of trusts.

The difference in the tax treatment of different types of trusts depends on whether the trust is or is not the beneficial owner of the income arising from the trust assets.

The «beneficial ownership of the income» can be considered the translation into English law language of the Italian wording «possession of income».

Thus, there are:

- i. trusts that are the beneficial owner of all their income, like the *charitable trusts* (sometimes defined as «non-transparent» trusts);
- ii. trust that have the beneficial ownership of certain incomes, and not of other incomes;
- iii. trusts that are not beneficial owner of any income arising from the trust assets (sometimes *improperly* defined as «transparent» trusts¹⁹).

«body of trustees». About this concept see P. Baker, *Double Taxation Conventions and International Tax Law*, 2nd ed., London, 1994, at 86 and seq.; K. Vogel, *On Double Taxation Conventions*, Boston, 1990, at 112; C. Sacchetto, «Brevi note sui trusts e le convenzioni bilaterali contro le doppie imposizioni sul reddito», in *Trusts e attività fiduciarie*, 2000, at 64 and seq.

¹⁹ Generally speaking, the concept of tax transparency is used to qualify some organizations (like partnerships) which are not considered as taxable entities, in which the income passes-through them directly to beneficiaries (for instance, see K. Vogel, *On double taxation conventions*, 3rd edition, London, 1997, at 99 and seq.).

In the Italian tax system transparent entities are not disregarded at all: they are liable to withholding taxes, they have to file Tax Returns, and so on. They are «persons», even if transparent for the income taxation purposes. Such transparent entities, like partnerships, are indicated in Article 5 ITC, and their list, provided for by the law, does not seem to allow additions by way of interpretation.

Thus, from an Italian perspective, trusts cannot be strictly qualified as «transparent entities», even if they are not liable to tax with regard to the income arising from the trust assets. As a consequence, in my opinion the only way to qualify «transparent trusts» is to deem them as persons liable to corporation income tax, that have a number of fiscal identification, are subject to withholding taxes, have to file tax returns, and so on. The absence of liability to tax for some or all of their incomes could be explained, rather than saying that they are not «persons», just pointing out that they are not the beneficial owner of such incomes.

Indeed, to use the concept of «transparency» with regard to trusts could be misleading: on one hand, there are trusts that are liable to income tax for certain incomes and not for others, so that the qualification of transparency, that has to be referred to the entity, could not be used; on the other hand, for those trust that are not liable to tax for any income, that does not depend on the qualification of the trust itself, since there is no rule, in Italian tax system, that states so, authorising to treat a trust as a transparent entity. The rule that, by way of interpretation, is useful to make a distinction between income taxed at the trust level and income taxed at the settlor or beneficiaries level, is that of the «possession of income», i.e. of the beneficial ownership. Even if, from a practical standpoint and in a domestic environment, there is no difference in considering a trust either «transparent» or non-beneficial owner of the income, in an international perspective some problems could arise from the improper use of the transparency concept.

As a consequence, the two models of trusts proposed by some writers (trust as persons, non-transparent and trust as non-persons, transparent) does not seem, in my opinion, systematically correct

The problem of the beneficial ownership could be addressed in a negative way: if a person (namely a beneficiary or the settlor) is entitled, according to the trust deed, to receive currently the income of the trust, then the trust will not be regarded as a beneficial owner of such income.

For instance, this is the case of bare trusts, of some purpose trusts, of fixed trusts, and so on.

From an Italian perspective, there are some categories of income for which it does not seem allowed to pass-through the trust for tax purposes, even if they are currently distributed to beneficiaries: they are income from real estates²⁰ and income from business activities²¹; as far as capital gains are concerned, it is necessary a case by case analysis, depending on the provision of the trust deed and the need, in the interpretation activity, to avoid double taxations or absence of taxation.

In trusts in which the income is not currently paid by the trustee, the trust itself is considered the beneficial owner of such income. This is the case of accumulation trusts, of discretionary trusts, of charitable trusts and of some other purpose trusts.

Finally, there are trusts that are the beneficial owner of some incomes and not for others. This point will be clarified *infra*, with the examination of some practical cases.

4. The determination of the taxable income of trusts

We have seen that a trust is considered as a person liable to corporation tax. It is generally qualified as a non-commercial entity, except in cases of trusts carrying on a business activity.

As a consequence, the rules regarding the determination of the taxable income of non-commercial entities, or commercial entities, will be applicable.

If a trust is not the beneficial owner of some incomes, then they will be taxed according to the fiscal situation of the beneficial owner.

There is, however, a peculiar problem with regard to trusts: the determination of the «cost» of the assets to be considered for the calculation of capital gains. Since the transfer of assets from the settlor to the trust has no price, there is the need to avoid double taxations or undue deductions²².

(for this interpretation see C. Garbarino, «La soggettività del trust nelle convenzioni per evitare le doppie imposizioni», *Dir. prat. trib.*, 2000, III, at 377 and seq.).

²⁰ According to Article 23 ITC income from real estates is taxed in the hands of the owner; since neither the settlor, nor beneficiaries can be qualified as «owners», the consequence is that the trust itself is liable to tax with regard to such income.

²¹ For a trust qualified as «commercial entity», due to its main activity, it would be very difficult to say that it is not the beneficial owner of the business income, even in case of current distribution of it to beneficiaries.

²² See R. Lupi, *La tassazione dei redditi del trust*, already quoted, at 328.

A good solution is to apply the general principle of the ITC of continuity of the fiscal values: the trust will enter in its books the value that the assets have for the settlor²³.

5. Income taxation of the settlor

To study the position of the settlor, it is necessary to keep separated the tax effects of the transfer of the assets to the trust and the eventual subsequent liability to taxation for the income arising from the trust assets.

As far as the first issue is concerned, it is clear that no capital gain arises from the transfer of assets to the trustee: there is no price in this operation.

This rule suffers of an exception that regards the transfer of business assets. If an asset is allocated for purposes that are extraneous to those of the business, then the income taxation arises, regardless if this asset belongs to the inventories²⁴ or to fixed assets²⁵. In the first case, the market value of the inventory goods is added to the taxable income; in the second case, a capital gain, determined by difference between the market value of the asset transferred and its cost (net of depreciations already made), is added to the taxable income²⁶.

There are some trusts in which the settlor is still liable to tax with regard to the income of the trust assets.

It happens when the settlor does not transfer to the trustee the «full property» of an asset, but the «naked property», maintaining for himself the usufruct; as a consequence, the settlor is still entitled to the income arising from the asset and it is obvious that in such case he will be liable to taxation.

The same rule of taxation of the settlor is applicable when the settlor himself is

²³ Within the schedule of ITC regarding other incomes, and with regard to the rules concerning the computation of capital gains, it could be useful to read in a broad sense the provision of art 82, § 5, ITC: in case of acquisition subsequent to a donation, the cost of the asset for the donee is equal to the cost for the donor. Even if the transfer from the settlor to the trustee is not a donation, the ratio of the rule is quite clear: to ensure the continuity of the fiscal values between donor and donee; in the case of trust, there is the same need, and in a systematic approach this principle can be adopted as a general rule regarding trusts.

²⁴ See Article 53, § 2, ITC.

²⁵ See Article 54, § 1, lett. d), ITC.

²⁶ See M. Lupoi, *Trusts*, 2001, already quoted, at 761 and seq.; F. Paparella, «Trusts e destinazione dei beni a finalità extraprenditoriali», in AA. VV., *I trusts in Italia oggi*, already quoted, at 357 and seq.

It could be useful to point out the the setting up of a purpose trust, like a voting trust, could be seen as a business allocation: thus, even if there is a transfer of the property of a participation by the settlor, no revenue or capital gain arises for tax purposes.

On the other hand, a declaration of trust, by which the settlor becomes trustee of a family trust, and that regards, for instance, a real estate belonging to his business activity, will be seen as a taxable event, even if there is no transfer of the property of such real estate.

still entitled to receive the income of the trust assets, thus being the beneficial owner of such income.

For instance, see the following:

Case 1 – voting trust

Mr. A, shareholder resident in Italy of an Italian Company (I Co.), together with other stockholders, settle a voting trust (purpose trust) named «Voting», resident in Italy, appointing Mr. B as trustee; the corporate shares are placed in the trust «Voting», so that they can be voted for desired corporate management and development purposes.

According to the trust deed, the trustee has to pay immediately to the settlor any dividend received by I Co.

Tax treatment:

i. after the signature of the trust deed, the trustee files a request to the Tax Office to obtain the number of fiscal identification of the trust «Voting», that is qualified for tax purposes as «resident non commercial entity»;

ii. the shares are transferred to the trust «Voting» and are registered in the shareholders' records of I Co., under the name of the trust «Voting» or under the name of Mr. B, as trustee of the trust «Voting»;

iii. I Co. pays dividends to the trust «Voting», without any withholding tax²⁷; in its Withholding Tax Return it declares the payment of dividends to the trust «Voting»; it issues a certificate of payment of dividends for tax purposes, indicating also the amount of the income tax credit (imputation system) that pertains such dividends;

iv. according to the trust deed, the trustee has to pay immediately to the settlor the dividends received: hence, the trust «Voting» is not the beneficial owner of dividends, and acts as «agent for the payment of dividends» for tax purposes²⁸; the trustee, on behalf of the trust, requests to Mr. A, entitled to dividends for a share of 15 per cent of the capital of I Co., if he prefers the application of a final withholding tax of 12.5 per cent or if he is willing to file a request of exemption from withholding tax and to include such dividends in his personal income tax return, according to the rules of the imputation system; in both cases the trustee, under the name of the trust «Voting», issues a certificate of payment of dividend, and includes in the Withholding Tax Return of the trust all those information.

Finally, there is a case in which the trust is not considered as a person but as non-existent for tax purposes. This the case in which a settlor, by a declaration of trust,

²⁷ According to Article 27, Decree of the President of the Republic no. 600/73 (Income Tax Assessment Act).

²⁸ See Ministry of Finance, Instructions to the Withholding Tax Return 2000, form SK, at 61: «altro sostituto d'imposta che interviene nella riscossione di utili derivanti da titoli azionari».

appoints himself as trustee, assuming an equitable obligation toward some beneficiaries (fixed or discretionary trust), or for charitable purposes. In this case, in absence of any transfer of property of assets to a different person (i.e. to a trustee different from the settlor), it seems very difficult to argue that it has created an organisation not belonging to him.

The settlor maintains the control on the trust assets and on the incomes arising from them, even if the assets in trust become a «separate fund» from the estate of the settlor-trustee. The equitable obligation that arises could be qualified, for tax purposes, as an «obligation of destination» which, generally speaking, has no consequences from the fiscal standpoint²⁹. Of course, as previously pointed out, if the declaration of trust regards business assets, there could be the taxation of the revenue or of the capital gain, provided that such declaration implies a transfer of assets out of the business environment.

The recognition of a trust for tax purposes will take place in case of change of the person of the trustee, i.e. when a transfer of the property of the trust assets actually occurs from the settlor to a different person.

We should also remember some pathological cases of taxation of the settlor. This happens when the trust deed and/or the deed of transfer of the assets, for any reason, are void, or are a sham, or the trust cannot be recognised in the Italian law system because of reasons of public policy.

This also happens when a trust is disregarded due to anti-avoidance provision of income tax, provided for by Article 37-bis of the Income Tax Assessment Act³⁰. If the assets transferred to a trust consist in going-concerns, receivables, tax credits, participations and other kind of assets indicated in the rule above mentioned, and that transaction is made without a business purpose and with the aim to avoid taxation, then such transaction will be disregarded for tax purposes: in this case the settlor will be seen as the holder of the assets, notwithstanding that the transfer of the property has taken place, and will be subject to an assessment for income tax³¹.

Differently from the specific rules contained, for instance, in the US Tax Law, the fact that the trust is revocable or not seems to be without consequences on the rules of taxation of the settlor³².

²⁹ On the absence of effects of the acts of destination of income for tax purposes see M. Nussi, *L'imputazione del reddito nel diritto tributario*, Padua, 1996, at 219 and seq.; M. Miccinesi, «Reddito delle persone fisiche (imposta sul)», *Digesto*, IV ed., disc. priv., sez. comm., XII, Turin, 1996, at 173; L. Tosi, «La nozione di reddito», in «Imposta sul reddito delle persone fisiche», *Giur. sistematica*, already quoted, I, Turin, 1994, at 46.

³⁰ Decree of the President of the Republic no. 600/1973, already quoted.

³¹ The relationships between trusts and tax avoidance are very exiting; among the Italian rare studies on this topic, see Belluzzo, «La tassazione in Italia dei trusts», *il fisco*, 1999, at 7448 and seq.

³² Reference is made to the *grantor trusts* rules provided for by the US Internal Revenue Code; on this topic see recently C.M. Bruce, *United States Taxation of Foreign Trusts*, The Hague, 2000, at 92 and seq.

6. Income taxation of beneficiaries

As far as the payments to beneficiaries are concerned, firstly it is necessary to verify if those payments are «capital distributions»: in that case they are generally out of the scope of income taxation³³.

If such payments are considered income, it is necessary to verify if the trust is the beneficial owner of such income and consequently it is liable to tax with regard to such an income. If the answer is yes, then the income, still taxed at the trust level, loses its initial characterization.

Since Italy adopts a schedular system, there is no general definition of income as such in the Italian tax law. To be liable to income tax, income must fall within a taxable source listed in the law. If it is not within one of the sources made taxable by the legislation, no income tax is due with respect to that income.

That means that the money paid to beneficiaries, still taxed as income at the trust level, is not deemed to be «income» for tax purposes: it is just a destination of income already taxed, an amount of money equal to an income, net of taxes and expenses.

The payment of money out of income already taxed is not taxable; that's because it does not fall within a category of taxable income but, mainly, because of its lack of income nature, in a technical sense³⁴.

On the other hand, if neither the trust nor the settlor is not the beneficial owner

³³ The only case in which such distribution of capital could be taxed concerns the taxation of extraordinary gains within the schedule of business income, if the recipient is an entrepreneur and such distributions are connected to his business activity.

³⁴ See A. Giovannini, *Soggettività tributaria*, already quoted, at 432; M. Lupoi, *Trusts*, 2001, already quoted, at 801 and seq.; A. Fedele, *Visione d'insieme*, already quoted, § 4.

For instance, the owner of a real estate is liable to tax for the income arising from such source. If he pays such income to other persons, it is no more an income from real estate, since a person that is not a owner of a real estate cannot earn an income of such character. When the beneficiary, in other words, is not the beneficial owner of an income, he has no ownership of the source and, consequently, has no liability for income tax. (See A. Fedele, *Visione d'insieme*, already quoted, at 274).

It seems to me that such a fundamental concept of necessary matching between ownership of the source and taxation of the income has been forgotten by Secit (see *Resolution*, already quoted, at 23) when it states that «the payment of such income from the trust to beneficiaries does not change its income characterization and the same can be taxed in the hands of beneficiaries».

There are opinions according to which the payments to beneficiaries could be taxed as annuities, ex Article 47, lett. i), ITC, or as life annuity, ex Article 47, lett. b), ITC., or as «any other income, in an amount defined before, arising from capital» ex Article 41, § 1, lett. i), ITC (see for instance. F. Tundo, *Implicazioni*, already quoted, at 1297; Secit, *Resolution*, already quoted, at 23).

In my opinion, it should be excluded both the taxation ex Article 41, lett. i), since the beneficiary has not the ownership of the source (see A. Fedele, *Visione d'insieme*, already quoted, at 274), and the taxation due to periodical payments or as a life annuity, due the reason that such income have been already taxed at a trust level.

Finally, it should be remembered the rule preventing a legal double taxation, provided for by Article 127 ITC: since income of the trust assets have been already taxed at a trust level, a new taxation at the beneficiary level would lead to a legal double taxation, which is not allowed by our tax system.

of an income, then it is taxable in the hands of beneficiaries, according to its initial qualification.

Finally, if a beneficiary sells his beneficial interest, earning a capital gain, the tax treatment depends upon the nature of the right transferred. For instance, if the interest regards a trust owning a real estate, such a sale of interest cannot be qualified as a sale of real estate and, hence, it is not taxable³⁵. On the other hand, if a trust is owner of company shares, the capital gain arising from the transfer of a beneficiary interest in such a trust is taxable³⁶.

Case 2 – trust «Friends»

Some friends are the settlors of the Trust «Friends».

According to the trust deed, they transfer different amounts of money to the trustee, for the purpose to invest in shares of I Co. The trustee has full powers to decide the time and amount of each purchase or sale of shares, with the aim to earn capital gains. The settlors are beneficiaries of the trust in proportion to their contributions. Dividends received from I Co. are currently paid to beneficiaries, while the trustee has full powers to decide the accumulation of the proceeds of the trading activity or to make partial distributions.

Each beneficiary is entitled to sell his interest without limitation.

Tax treatment:

i. after the signature of the trust deed, the trustee files a request to the Tax Office to obtain the number of fiscal identification of the trust «Friends», that is qualified for tax purposes as «resident non commercial entity»;

ii. the shares are bought under the name of the trust Friends, and are registered as such in the shareholders' records of I Co;

iii. I Co. pays dividends to the trust «Friends», without any withholding tax³⁷; in its Withholding Tax Return it declares the payment of dividends to the trust «Friends»; it issues a certificate of payment of dividends for tax purposes, indicating also the amount of the income tax credit (imputation system) that pertains such dividends;

iv. according to the trust deed, the trustee has to pay immediately to the beneficiaries the dividends received: hence, the trust «Friends» is not the beneficial owner of dividends, and acts as «agent for the payment of dividends» for tax purposes³⁸; the trustee, on behalf of the trust, requests to each beneficiary if he prefers the application of a final withholding tax of 12.5 per cent or if he is will-

³⁵ This case is substantially equivalent to a person that transfers his right to buy a real estate, according to a preliminary contract. The capital gain earned by such transfer is not taxable in Italy.

³⁶ See Article 81, lett. c), ITC, according to which capital gains arising from the sale of «rights by which it is possible to acquire participations» are taxable.

³⁷ According to Article 27, Decree of the President of the Republic no. 600/73 (Income Tax Assessment Act).

³⁸ See Ministry of Finance, Instructions to the Withholding Tax Return 2000, form SK, at 61: «altro sostituto d'imposta che interviene nella riscossione di utili derivanti da titoli azionari».

ing to file a request of exemption from withholding tax and to include such dividends in his personal income tax return, according to the rules of the imputation system; in both cases the trustee, under the name of the trust «Friends», issues a certificate of payment of dividend, and includes in the Withholding Tax Return of the trust all those information;

v. capital gains arising from the trading activity will be taxed under the name of the trust «Friends» at the rate of 12.5 per cent (or 27 per cent, in case of sale of «qualified participations»), according to the rules of the Capital Gain Tax on sale of participations;

vi. in case of distribution of the proceeds of the trading activity, inclusive of capital gains, to the beneficiaries, no taxation will take place;

vii. the capital gain earned by a beneficiary from the sale of his interest in the trust is subject to Capital Gains Tax, at the rates above indicated.

7. International tax aspects of trusts

We have seen that trusts are qualified as persons for income tax purposes, liable to corporation income tax.

Then, a problem of fiscal residence of trusts arises.

According to Article 87 ITC, entities are considered resident in Italy if they have in Italy, for more than 183 days in the fiscal year, their registered office, or their administrative office or their main object.

With regard to trusts, we could say that the concept of «registered office», which is derived from the company law, could be «translated» as the address or location of the administration of the trust; the «administrative office» as the place of management and control of the trust; the «main object», as the location of the main assets of the trust.

Other criteria, like the fiscal residence of the trustee³⁹ or the place in which the trust deed has been signed, does not affect the fiscal residence of the trust.

As far as the tax conventions are concerned, some issues arise:

i. is a trust a «person» for treaty purposes? The general answer is yes: the trust is considered a person⁴⁰;

³⁹ The interpretation that focuses on the fiscal residence of trustees to determine the residence of a trust is clearly connected to the idea of the trustee as the person liable to tax with regard to the trust income. I do not agree with that interpretation. See G. Marino, «La residenza fiscale del trust», *Trusts e attività fiduciarie*, 2000, at 72 and seq.

⁴⁰ See P. Baker, *Double taxation convention and international tax law*, London, 1994, at 83 and seq.; C. Sacchetto, *Brevi note*, already quoted, at 66.

It should be noted that trust as a person is literally included in the tax treaties between Italy and UK, US, Canada, Philippines, Kenya and New Zealand (see M. Lupoi, *Trusts*, 2001, already quoted, at 754, note 592).

ii. where is the trust resident? It is deemed to be resident of the State in which its place of effective management is situated⁴¹;

iii. is the trust the beneficial owner of dividends, interest and royalties? In my opinion, it depends – from an Italian perspective – on the type of trust, as above indicated⁴²;

iv. in a triangular case, where the trust is resident in State T, the asset is located in State S and the beneficiary is taxed in State B, in which country a capital gain arising from the disposal of such asset should be taxed? In the State of residence of the trust⁴³;

v. in case of capital gain arising from the sale of a beneficiary interest in a real estate trust, is it taxable in the country of residence of the beneficiary or in the country in which the real estate is located? In the first country, unless a specific rule of the convention has a different provision⁴⁴;

vi. in which article of the convention do the payments to the beneficiaries fall? If the trust is the beneficial owner of the income arising from the trust assets (i.e. dividend or interest), the subsequent payments to beneficiaries fall in the provision regarding «other income»; if not, the beneficial owner remains, depending on the type of trust, the settlor or the beneficiary, and then the income maintains its original characterisation, falling in the relevant provision of the convention (i.e. dividend or interest)⁴⁵.

That means that a trust settled in Italy, by an Italian settlor, with an Italian trustee, could be considered non resident in Italy if, for instance, its place of management is located abroad.

Case 3 – trust «Florence»

An English gentleman is the settlor of a bare trust, named «Florence». His English lawyer is the trustee. The trust asset is a villa in the Tuscany countryside.

⁴¹ See P. Baker, *Double taxation*, already quoted, at 86; C. Garbarino, «La soggettività del trust nelle convenzioni per evitare le doppie imposizioni», *Dir. prat. trib.*, 2000, III, at 394.

⁴² In my opinion the beneficial ownership, with regard to trust, should be considered as equivalent to the concept of «subject to tax». If a trust is liable to tax with regard to a certain income in its country of residence, then it can be deemed as the beneficial owner of the income; if it is not, and the person liable to tax, with regard to an income, is the beneficiary, then the latter should be deemed as the beneficial owner, thus applying the convention with the State of his residence. In this perspective, the concept of beneficial ownership should be interpreted in a meaning which is functional to the rules of international taxation, rather than in its traditional sense of common law countries. For the same opinion see P. Baker, *Double taxation*, already quoted, at 87; C. Sacchetto, *Brevi note*, already quoted, at 69; see also C.P. du Toit, *Beneficial Ownership of Royalties in International Tax Treaties*, Amsterdam, 1999, at 116 and seq., that seems to exclude, however, a beneficial ownership of the trust itself.

⁴³ *Contra* see P. Baker, *Double taxation*, already quoted, at 87 and C. Sacchetto, *Brevi note*, already quoted, at 70: for this scholars the correct answer should be «in the State of residence of the trustee». But since there is a general agreement that the trust itself is deemed to be a person, resident in the State of its place of management, the reference to the State of residence of the trustee in my opinion seems meaningless.

⁴⁴ See P. Baker, *Double taxation*, already quoted, at 88.

⁴⁵ See P. Baker, *Double taxation*, already quoted, at 88, but without a distinction on the basis of the concept of beneficial ownership.

The trust earns a rent, which is currently paid to the beneficiary, the nephew of the settlor, resident in Paris.

Tax treatment:

- i.* from an Italian perspective, the trust is deemed to be resident in UK;
- ii.* the villa is registered under the name of the trust «Florence», which has a number of fiscal identification in Italy;
- iii.* in Italy, the person liable to income tax for the income (rent) is the trust «Florence», even if it is a bare trust⁴⁶: the trustee has to file the income tax return under the name of the trust;
- iv.* from an Italian perspective, the beneficiary resident in France has no tax liability;
- v.* in case of sale, by the beneficiary, of his interest, the capital gain earned is not taxable in Italy: from an Italian perspective, it should be treated according to the provisions of the tax treaty between UK and France.

⁴⁶ As I have pointed out before, for income from real estates the trust is always deemed to be the beneficial owner of it, even if it is a bare trust.