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Law No. 97 of August 6, 2013, significantly amended the Italian statutory provisions on a taxpayer's duty to report foreign investments or foreign financial assets on Italian income tax returns. The most significant change now requires that taxpayers who qualify as beneficial owners of reportable investments or assets have a direct duty to report their beneficial ownership share of those investments and assets.

The term ''beneficial owner'' for international tax reporting purposes is defined according to the definition of beneficial owner in the anti-money-laundering legislation. According to that definition, a taxpayer may qualify as beneficial owner of the underlying reportable investments or assets whenever the taxpayer indirectly owns the assets or investments through a company or other entity that she controls or holds a significant interest in. The duty to report no longer requires that the taxpayer directly owns the legal title to, or any other legal right or power of use, enjoyment, possession, or disposition of, the reportable investment or asset.

For assets held in trust, depending on the legal and tax characterization of the trust under Italian tax rules, the duty to report may fall on the trustee acting for the trust, the settlor, or the beneficiaries. The new international reporting provisions for assets held in trust interact to a significant extent with the Italian tax rules on trusts, and they may be complex depending on the circumstances.

The other changes brought about by Law No. 97 include:

- the scope of reporting is now limited to the fair market value of the reportable investments and assets at the beginning and end of the tax year or at the time of disposition;
- the minimum value of the reportable investments or assets, previously set at €10,000, has now been eliminated; and
- the penalties for failure to timely report have been significantly reduced.

Italy's tax administration issued Circular No. 38 of December 23, 2013, to provide interpretative guidance on the application of the new reporting rules.

Taxpayers Subject to Reporting

Taxpayers subject to reporting are individuals and noncommercial companies or entities resident in Italy for tax purposes; noncommercial entities include trusts.

For individual taxpayers, the tax residency requirement is met when any of the following alternative tests is satisfied for more than half of any tax year:

- an individual is registered in the Italian register of people living in Italy, which is held by the municipal office where the individual established her permanent residential address (registration test);
- an individual has residency in Italy for general civil law purposes (residence test); for this purpose, residency means physical presence (objective test) coupled with the intention to live in Italy for the indefinite future (subjective test); or

- an individual has her domicile in Italy for general civil law purposes (domicile test); for this purpose, domicile means the main center of an individual's personal, professional, business, or economic interests, regardless of the individual's physical presence in a specific place.

Given the nature of the tax residency tests (which, except for the registration test, are highly factual), a foreign individual who spends significant time in Italy or establishes significant ties there when buying a home, running a business, or making other investments may easily cross the Italian tax residency line. Italy's tax agencies are conducting more frequent audits on foreign taxpayers with material interests in or contacts with Italy. When that happens, an individual could become subject to the tax reporting rules for all of her assets held outside Italy — a potential nightmare that should be avoided at all costs.

A trust is resident in Italy if it maintains in Italy for most of its tax year its place of administration or management or its principal place of business.

The foreign country where the trust has been established or the foreign law under which the trust has been created is not relevant to characterize the trust as resident or nonresident for Italian tax purposes.

A potential trap here is to think that just because a trust is a foreign trust under its own organizational law or the tax laws of the foreign country in which it has been established, it should not be subject to tax in Italy. On the contrary, any connection with Italy, either through the trust's settlor or beneficiaries, or through the location of all or part of the trust assets, should trigger a deeper analysis of potential tax issues in Italy.

The place of administration of the trust is presumed to be the place where the trustee resides, unless the taxpayer provides sufficient evidence of the actual place where the trust is administered or managed, if different from the trustee's country of residence. The main place of business of the trust is where most of the activities of the trust are carried out or most of the trust assets are located.

Italy's tax law on trusts establishes two presumptions of Italian tax residency. The presumptions can be rebutted by clear and convincing evidence.

The first presumption deems a trust to be resident in Italy if (1) it is organized or established in a country that is not included on a special white list adopted by decree of the minister of economy, and (2) a settlor or a beneficiary is an Italian tax resident individual.

The second presumption deems a trust to be resident in Italy if (1) it is organized or established in a country that is not included on a special white list approved by decree of the minister of economy, and (2) at any time after the creation or establishment of the trust, an Italian tax resident individual makes a transfer to the trust of the ownership or any other limited rights on real estate properties, wherever located.

Reportable Foreign Investments

Reportable foreign investments include property located or held outside Italy that is capable of generating foreign-source income subject to tax in Italy, in the form of dividends, interest, or gain from the sale or exchange of the investment or assets. Reportable foreign investments include personal or investment assets such as artwork, jewelry, cars, and collections. Reportable financial assets include bank accounts, stocks, bonds, mutual funds, life insurance, and any other financial investments generating income (in the form of interest, dividends, or capital gains) that would be taxable in Italy.

In addition to full ownership rights, partial rights on a foreign reportable investment or financial asset, such as easements, life estates, leaseholds, rights of use, and future interests such as reversions or remainders, must be reported. For jointly owned assets, both owners are required to report the full value of the assets, as well as their individual shares. For assets owned jointly with the full power of possession and enjoyment for each of the owners, both owners are required to report the full value of the assets. Bank accounts must be reported by the holder or joint holders of the account, and by any individual with signatory authority on the account and the power to withdraw money for her own benefit (as opposed to an agent acting for the principal or a corporate account holder).

Direct Ownership

The duty to report applies whenever a taxpayer is the direct legal owner of the relevant right on a reportable foreign investment or asset.

Ownership Through Intermediaries

The duty to report also applies when the taxpayer indirectly owns the relevant right to the reportable foreign investments or assets through an intermediary such as an agent, nominee, or other conduit arrangement.

A disregarded trust is considered an intermediary for international tax reporting purposes, which means the duty to report applies to either the settlor or the beneficiaries, depending on who is the real owner of the trust assets.

A trust is disregarded whenever the settlor does not make a real, final, and complete transfer of her assets to the trust, but retains sufficient powers of control and disposition over the assets to be considered the actual owner of the trust assets. A trust that the settlor can revoke at any time is a disregarded trust. The same applies to a trust in which the trustee is not entrusted with real and effective powers of administration and management that can be carried out independently from the settlor, but depends and acts to a significant degree on the instructions, guidance, directions, or will of the settlor or the beneficiaries. Similarly, a trust is disregarded and the beneficiaries are treated as the real

indirect owners of the trust assets whenever the beneficiaries have an unconditional right to obtain the immediate distribution of the trust assets in advance of the termination of the trust, or any other unconditional and unlimited right of use, enjoyment, and possession of the trust assets. The powers of the settlor or beneficiaries that are relevant for purposes of treating the trust as a disregarded arrangement are tested by referring to the terms of the trust agreement.

Power of Enjoyment and Disposition

The duty to report applies whenever the taxpayer has the actual power of possession, disposition, and enjoyment of the reportable investments or assets, regardless of who appears to be the legal owner of those assets.

Indirect Ownership

Law No. 97 extends the reporting obligations to taxpayers who are the beneficial owners of a reportable foreign investment or asset. For investments or assets owned indirectly through companies or other entities, the beneficial owner is defined as follows:

1. For investments or assets owned by commercial companies or other entities,

   a. individuals who own directly or indirectly a sufficient number of shares of stock, equity interests, or voting power in the entity to exercise the control of that entity, or

   b. individuals who control the entity by any other means such as contractual arrangements, voting agreements, and so forth.

   The law establishes a non-rebuttable presumption of control whenever an individual directly or indirectly owns more than 25 percent of the shares or capital of the company or entity (ownership test).

   For indirect ownership interests held through a chain of companies, the ownership test is computed at each level of the chain by multiplying the percentage of the shares owned directly and indirectly in each lower-tier company at each level of the chain. Therefore, a taxpayer who owns 50 percent of Company A, which owns 51 percent of Company B, is considered to be the beneficial owner of both Company A and Company B for international tax reporting purposes.

   If the companies directly or indirectly controlled under the more-than-25-percent ownership test are organized in white-listed countries, the taxpayer must report the value and percentage of her direct and indirect interests in those companies, to the extent that the more-than-25-percent ownership is satisfied (the so-called separate entity approach). In the example above, if Company A and Company B are both organized in a white-listed jurisdiction, the taxpayer who is the beneficial owner of those companies reports her direct share of 50 percent in Company A and indirect share of 25.5 percent in Company B, and their respective values.

   For companies organized in non-white-listed countries, the taxpayer must report the value of her shares in each of the underlying investments and assets owned by each company in the chain for which the ownership test is satisfied, and must keep a separate list of the single investments and assets owned by each of those companies (the so-called look-through approach). In the example above, if Company A and Company B are organized in non-white-listed countries, the taxpayer who is the beneficial owner of those companies must report her 50 percent direct interest and 25.5 percent indirect interest in the underlying investment and assets of those companies, together with the percentage of her direct and indirect ownership interest in the companies to which they relate, and must keep a separate list of those underlying investments and assets to make available to the tax administration upon request.

2. For investments or assets held in trust whose individual beneficiaries are identified and named in the trust agreement, a beneficial owner is any beneficiary who owns more than 25 percent of the assets of the trust (qualified beneficiaries);

3. For foundation or similar entities, all individuals who exercise the control over the assets of the entity are beneficial owners.

The beneficial owner of the trust as defined above must report her share of the underlying assets owned directly or indirectly by the trust. If the trust directly or indirectly owns interests in other companies or entities organized in white-listed countries, the beneficial owner must report her share of the trust's interests in those companies. But if the lower-tier entities owned directly or indirectly by the trust are organized in non-white-listed countries, the beneficial owner must report her share of the underlying investments or assets owned by those lower-tier companies under the look-through approach.

In order to apply the more-than-25-percent ownership test, the shares owned by some family members (spouses, third-degree linear descendants, second-degree collaterals) are reciprocally attributed to each of them.

The beneficial owner rule applies exclusively for interests owned in foreign companies or entities. The ownership of an interest in an Italian company matters solely for the purpose of computing the indirect ownership interest in a foreign company, which may trigger the duty to report. In the example above, if Company A is an Italian company that directly owns foreign investments and assets, the taxpayer who owns 50 percent of Company A does not have to report any of the foreign investments or assets owned by Company A.

However, as a result of owning 50 percent of the stock in Company A, the taxpayer indirectly owns 25.5 percent of Company B. If Company B is a foreign company, the taxpayer is a beneficial owner of Company B and must report her indirect share of the underlying reportable investments and assets owned by Company B, together with the percentage of her indirect interest in Company B.

International Tax Reporting and Trusts

For assets held in trust, the following situations may be envisaged:

- *Italian resident trust with no Italian beneficial owners*. The duty to report falls on the trust if it is a trust resident in Italy for Italian tax purposes under the place of administration or place of business test.
- *Italian resident trust with one or more Italian beneficial owners*. Each beneficial owner has the duty to report her own share of the reportable foreign investments and assets of the trust, both for an Italian resident trust and for a nonresident trust.
- *Italian resident trust with Italian beneficial owners of a total aggregate share of less than 100 percent of the trust assets*. The trust must report the share of its reportable foreign investments or assets not attributable to its beneficial owners.
- *Italian resident trust with no Italian beneficial owners*. The trust must report all of its reportable foreign investments and assets.
- *Nonresident trust with one or more Italian beneficial owners*. Each beneficial owner has the duty to report her own share of the assets of the trust, both for an Italian resident trust and for a nonresident trust.
- *Nonresident trust with Italian beneficiaries, none of whom is a beneficial owner*. No beneficiary is under an obligation to report, either under the direct ownership rule or the new beneficial owner test; however, careful consideration must be given to the term of the trust and the facts of the case to determine whether the settlor or any of the beneficiaries of the trust may be required to report under the other tests (actual possession of right of enjoyment of trust assets, or intermediate possession of the trust assets through an agent or nominees structure).

Circular 38E of December 23, 2013, states:

> With reference to foreign trusts with identified Italian resident beneficiaries, the latter are subject to the duty to report the assets held by the trust in the event that they are beneficiaries of a significant portion of those assets in accordance with the anti money laundering statute. *A beneficiary of a foreign trust who is not a beneficial owner of the trust, is required to report on form RW his or her interest in the trust*. [Emphasis added.]

The last sentence is inconsistent with the general rule whereby the duty to report applies only when a taxpayer owns a reportable foreign investment or asset (unless the beneficial ownership rule applies). This is not the case for a beneficiary of future payments or distributions from the trust who does not own the assets unless and until they are actually distributed upon the expiration of the trust. It is also inconsistent with the beneficial ownership rule, which requires the reporting of underlying assets held indirectly through a trust or other intermediate entity only when a taxpayer owns more than 25 percent of the ownership interest in that intermediate entity and qualifies as a beneficial owner.

Subject-to-Tax Requirement

The tax administration has clarified that an investment is reportable to the extent that it can generate taxable income at any time in the future, even though it has not generated any in a particular tax year. As a result, an apartment or house held outside Italy is a reportable foreign asset, even if it is used as a personal home or investment property and does not generate any taxable income.

No specific guidance has been provided by the tax administration on the new beneficial ownership rule. The application of the subject-to-tax rule may give rise to uncertainty in cases of discretionary foreign trusts that are deemed to own the income arising from the trust assets for tax purposes, or foreign trusts with income beneficiaries that are not Italian resident individuals. In both of these situations, there would be no income subject to tax in Italy, and the subject-to-tax test would not be satisfied.

A foreign trust that is treated as the owner of the income arising from the assets held in trust for tax purposes is not taxable in Italy unless the assets are located in Italy, and the income from them qualifies as Italian-source income. Italy does not tax the income of the trust in the absence of any relevant nexus with Italy, either at the level of the trust, which is a foreign trust, or at the level of the income, which is foreign-source income. Italy applies its own rules to determine whether the trust is the owner of the income for tax purposes, and it assumes that the income of the trust, when earned, is taxed in the foreign country of organization of the trust and becomes part of the corpus of the trust. When the value of the trust, including the accumulated income, is ultimately distributed to the beneficiaries, Italy does not apply a second tax, even though the beneficiaries are Italian resident individuals.

For a trust with income beneficiaries identified in the trust agreement, Italy taxes the beneficiaries on their shares as determined under the terms of the trust. However, when the income beneficiaries are nonresident individuals and the income is foreign-source income arising from foreign investments, assets, or activities of the trust, there is no nexus with Italy, and Italy does not impose any tax.

In each of the situations described above, the subject-to-tax requirement necessary for the application of the duty to report is not satisfied.

Value to Report

The reportable foreign investments or financial assets must be reported at FMV, computed at the beginning and end of the tax year, or at the time of sale of the investment or asset.

Penalties

The report is due with the income tax return by the filing deadline of September 30.

The penalties for failure to report are now assessed at a minimum of 3 percent and a maximum of 15 percent, and doubled to 6 percent minimum and 30 percent maximum for investments or assets located in blacklisted jurisdictions. ◆