Time to choose

The impact of the EU Succession Regulation on Italian trust and estate planning

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Abstract

- ***Regulation (EU) No.650/12*** **(the Succession Regulation) will change Italian conflict-of-law rules. The connecting factor that determines the law applicable to succession will become the habitual residence of the deceased instead of the nationality of the deceased.**
- **The Succession Regulation will also change the criteria by which the choice of law governing succession is made, as it avoids *renvoi* and thus allows clients to plan their succession by choosing the law of their nationality.**
- **The *Hague Convention of 1 July 1985 on the Law Applicable to Trusts and on Their Recognition* (Hague 30) came into force in Italy on 1 January 1992. Italy recognises trusts as instruments of succession planning.**
- **Italy has a worldwide tax system. The Italian inheritance tax (IHT) regime is extremely favourable where succession involves the spouse and children of the deceased as heirs or legatees. The threshold under which no IHT is due is high, amounting to EUR1 million for each beneficiary.**

On 17 August 2015, *Regulation (EU) No.650/2012* (the Succession Regulation) will be wholly applicable. As this date approaches, lawyers are still struggling to clarify myriad unresolved issues regarding the new European succession system.

Italian conflict-of-law rules will undergo a big change, as the connecting factor that determines the law applicable to succession will shift. As a result, the Succession Regulation will have an impact on non-nationals who have settled in Italy (in most cases after they retire), as they will have the opportunity to plan their succession by choosing the law of their nationality; a choice that was not available before.

THE RULES APPLICABLE IN ITALY UNTIL 16 AUGUST 2015

The connecting factor

Until 16 August 2015, under Italian private international law (PIL),[1] the succession of a person will be governed by their national law at the time of their death. If the deceased has multiple nationalities, the law of the country to which they were mostly connected will apply; however, if one of these nationalities is Italian, Italian citizenship will prevail.[2]

It is important to note that the law applicable to the succession will govern all inheritance matters, from the opening of the succession to the division of the deceased's estate. The administration of the estate will, therefore, be included.

The choice of law

Professio juris is admitted under set and strict conditions.[3] In particular, the testator can choose the law governing their entire succession, but only the law of the state where they reside, provided that such a choice is expressed in the form of a will and the person is resident in that state at the time of death. No other kind of choice is admitted (implied choice, for example, is not allowed). As a result, if the deceased, at the time of death, has changed their residence, the choice of law will be ineffective.

Furthermore, with regard to the succession of an Italian citizen, the choice of law cannot affect the rights granted by law to Italian heirs who are resident in Italy at the time of death (the so-called forced heirship rights, which are usually granted only to the spouse and children of the deceased, but which may be granted, in certain cases, to parents or descendants of the deceased). The testator cannot, in any way, violate these rights unless the heirs are resident abroad at the time of the testator's death.

Renvoi

Renvoi back to Italian law made by the law of nationality of the deceased is accepted under Italian PIL. If there is a *professio juris*, *renvoi* is excluded.[4]

Under the present Italian PIL rules, *renvoi* will not operate if the law of residence is chosen. As a result, a British national residing in Italy could not choose English and Welsh (or Scottish) law as governing their succession, only Italian law (the law of the place of residence). *Renvoi* made by English and Welsh PIL rules (the law of nationality) back to Italian law, cannot be avoided by electing for English and Welsh law to govern the succession in the form of a will.

ITALY AND THE SUCCESSION REGULATION

Connecting factor

Under the Succession Regulation, the habitual residence of the deceased at the time of death will be the connecting factor. It will be the default rule to determine the law applicable to the entire succession. In other words, the applicable law will govern all questions related to the succession, from the start of the succession to the transfer of ownership of the assets forming part of the estate to the beneficiaries, including the administration of the estate.

Under article 21.1 of the Succession Regulation, the law of the state in which the deceased was habitually resident at the time of death might also be the law of a 'third state' (so-called *erga omnes* or universal application). If the law determined under article 21.1 is the law of a state bound by the Succession Regulation, the existence of a uniform connecting factor will avoid any conflict of laws. On the other hand, when the law of habitual residence is the law of a third state, the PIL of that state should be considered. If those rules provide for *renvoi* either to the law of a member state or to the law of a third state that would apply its own law to the succession, such *renvoi* should be accepted.

Therefore, the meaning of 'member state' and 'third state' under the Succession Regulation must be established. For example, what about the EU member states that have not adopted the Succession Regulation? Are they 'member states' or 'third states'? As the Succession Regulation does not contain a definition of 'member state' (unlike other instruments of European private law and the Succession Regulation proposal), a future decision of the European Court of Justice will be required to solve this important matter of interpretation.

In this respect, recital 82 of the Succession Regulation indicates that the UK and Ireland are member states, despite these states 'not taking part in the adoption of this Regulation and... not [being] bound by it or subject to its application'.

1. Article 46 of *Law No.218/1995*
2. Article 19 of *Law No.218/1995*
3. Article 46 of *Law No.218/1995*
4. Article 13 of *Law No.218/1995*

The Succession Regulation should be workable and systematically coherent, so we tend to agree with those scholars who have underlined how the inclusion of Denmark, UK and Ireland among the 'member states' for the purposes of the Succession Regulation would lead to a lack of consistency. Until this problem of interpretation is resolved, we will surely face some practical problems. A possible way to reduce uncertainty is to advise clients to make a choice of law when possible and suitable. As we shall see later, *renvoi* is excluded if the deceased had made a choice of law in favour of the law of a third state.

Choice of law

The Succession Regulation allows the testator of the disposition of property upon death (DoPuD) to make a choice of law. Article 22 provides that the testator can elect the law of their nationality (or, if they have multiple nationalities, the law of one of their nationalities) at the time of choice or at the time of death (it will be important to clarify this point, because the choice will remain valid even if the testator loses or changes nationality).

The choice of law can be made expressly in a declaration in the form of a DoPuD or can be implied (i.e. demonstrated by the terms of such a disposition).

It is worth noting that article 83 of the Succession Regulation extends the range of valid choice of law that can be made during the transitional period: 'Where the deceased had chosen the law applicable to his succession prior to 17 August 2015, that choice shall be valid if it meets the conditions laid down in Chapter III or if it is valid in application of the rules of private international law which were in force, at the time the choice was made, in the State in which the deceased had his habitual residence or in any of the States whose nationality he possessed.'

Renvoi

As mentioned above, *renvoi* shall be applicable only if the law of habitual residence is the law of a third state. In the case of a choice of law made in a DoPuD, all states bound by the Succession Regulation shall apply only the substantial applicable law (i.e. PIL rules are excluded) and no *renvoi* shall be admissible.

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The above rule applies in any case of choice of law (whatever the chosen law is – i.e. the law of a member state or the law of a third state). In fact, recital 57 expressly provides that: '*Renvoi* should, however, be excluded in situations where the deceased had made a choice of law in favour of the law of a third state'.

This begs the question: would the third state whose law has been chosen (e.g. the UK) respect such a choice, or would it apply any possible *renvoi* to another law provided by its PIL rules? An answer to this question should be given on a case-by-case basis, depending on the law chosen. In our opinion, conflict of laws cannot be avoided in principle.

A PRACTICAL EXAMPLE

Mark, a British national who had moved with his wife to Italy from England in 1998, died in Italy in 2014. Under article 46 of *Law No.218/1995*, English law applies to his succession. Mark's estate comprised a house and a bank account in Italy and a bank account in England. The *renvoi* to English law would include the conflict-of-law rules. The English PIL provides for two different connecting factors related to the nature of assets (real estate or movables). The succession of movables is governed by the law of domicile, while the succession of real estate is governed by the *lex situs* (*lex rei sitae* is the Latin expression used by civil lawyers). Therefore, Mark's succession of the house in Italy will be governed by Italian law (which accepts the *renvoi* back). Should Mark be deemed domiciled in Italy at the time of death, the succession of the bank accounts (in Italy and the UK) shall also be governed by Italian law. The application of Italian law, of course, implies the application of rules regarding forced heirship provided by Italian law.

Under article 46 of *Law No.218/1995*, Mark could not choose English law as the law governing

his succession in order to avoid the *renvoi* back to Italian law. Under the Succession Regulation, however, this choice would have been possible under article 22, as Mark is a British national. Italy, as a member state to the Succession Regulation, will be bound to respect such choice and no *renvoi* back to Italian law will be accepted under article 34.2.

The PIL rules of the third state (the UK in the example above) should apply only if the law applicable to the succession is the 'default law', that is the law applicable under article 21.1 ('the law of the State in which the deceased had his habitual residence at the time of death'), and not when the law applicable to the succession is expressly (or impliedly) chosen by the testator.

According to UK scholars and practitioners, the above choice should also be respected by the UK. Whether or not the European certificate of succession issued in Italy (the place of habitual residence) will be accepted in the UK is an open issue. It is also questionable if the UK would respect the choice of national law made by an Italian national habitually resident in the UK. Would the UK apply Italian law to assets situated in the UK?

THE RECOGNITION OF TRUSTS IN ITALY

Italy has recognised trusts since the *Hague Convention of 1 July 1985 on the Law Applicable to Trusts and on Their Recognition* (Hague 30) came into force on 1 January 1992. The Convention was ratified by Italy in 1989.[5] Hague 30 contains a definition of 'trust' in article 2 'for the purposes of this Convention', which means that the definition is not identical to that of the English and Welsh trust. Italian scholar Maurizio Lupoi argues that the trust defined by article 2 of Hague 30 is a 'shapeless trust' because it refers not only to English and Welsh trusts but also to the so-called trust-like institutions, so Hague 30 may also apply to these kinds of legal institutions (e.g. foundations).[6]

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Italy only recognises express trusts (*inter vivos* or *mortis causa* trusts) under article 3 of Hague 30, i.e. trusts created voluntarily and evidenced in writing. Constructive trusts, resulting trusts and implied trusts are outside the scope of the Convention. The Italian courts cannot 'create' a trust (e.g. where property is obtained or retained by unconscionable conduct).

Italy must address a number of problems around the recognition of trusts. First, for a trust to be recognised in Italy, it must be consistent with the provisions of article 2 of Hague 30: the assets must have been placed under the control of a trustee. For example, the US revocable trust (under s603 *Uniform Trust Code*, also called a 'living trust'), in which the trustee's duties run primarily, and perhaps even exclusively, to the settlor, does not appear consistent with article 2, because assets are not placed under the control of a trustee. A power of revocation, in fact, is the functional equivalent of ownership.

Another problem arises with regard to rights and powers retained by the settlor. Rights and powers reserved under the law governing the trust can in fact be inconsistent with article 2 of Hague 30 (e.g. the powers reserved by the settlor under s9A *Trusts (Jersey) Law 1984*). A trust in which the settlor reserves to themselves the powers provided by s9 *Trusts (Jersey) Law 1984* is probably not a trust 'for the purposes of the Convention'.

Under article 4, Hague 30 does not apply to preliminary issues relating to the validity of wills or of other acts by virtue of which assets are transferred to the trustee. These acts are governed by the *lex fori* – for example, if an English settlor wishes to transfer to the trustee an immovable asset located in Italy, a notarial deed must be used to register the transfer in the Italian Land Registry.

Since Hague 30 has come into force, Italian practitioners have begun to explore if the convention would allow the creation of trusts in the absence of foreign connecting factors, aside from the applicable law. A wide interpretation of Hague 30 led to the creation of the so-called 'internal trust' – i.e. 'a trust whose elements are all connected with Italy except for the applicable law, that is a law of a trust country'.[7]

5. *Law No.364 of 16 October 1989*

6. 'The Shapeless Trust', *Trusts & Trustees*, (1995), no.3, 15
7. Maurizio Lupoi, *Trusts*, (Milan, 2001), 536

In an internal trust, the settlor is Italian, the trustee is Italian, the assets are located in Italy, and the beneficiaries are Italian. The Italian court approved this experiment and now the creation of internal trusts is common in Italy. Statistically, the majority of internal trusts are governed by English and Welsh trust law or by the *Trusts (Jersey) Law 1984*, but sometimes professionals are unaware of the applicable law. The application of the wrong choice of law to the trust can result in critical situations.

Internal trusts may be classified as follows:

- **accumulation and maintenance trusts (i.e. discretionary trusts);**
- **trusts to preserve family-owned businesses; or**
- **trusts for persons affected by a disability.**

As for the assets of internal trusts, mainly the settlor entrusts real property (e.g. the matrimonial home) and shares in limited liability companies.

A number of succession issues arise from trusts operating in Italy. Article 15 of Hague 30, in fact, contains an important provision regarding the protection of heirs and legatees. Hague 30 does not prevent the application of provisions of the law designated by the conflicts rules of the forum, in so far as those provisions cannot be derogated from by voluntary act, relating to succession rights, testate and intestate, especially the indefeasible shares of spouses and relatives. This provision protects forced heirship rules against family trusts.

Trusts cannot withstand a challenge in court by a disappointed heir; this is a real limitation to the use of trusts in Italy. Therefore, if the succession is governed by Italian law, the trust may be successfully challenged in court. Yet, trusts in which some future heir of the settlor is not a beneficiary are very rare and the trust instrument contains clauses that dissuade the heir to challenge the trust, because they obtain more than the indefeasible portion. Case law considering trust and forced heirship is absent in Italy, except one case about jurisdiction, in which the Supreme Court stated: 'The agreement concerning jurisdiction (prorogation of jurisdiction clause) established in the trust instrument is not binding for a "third party" (i.e. someone who is neither the settlor, nor the trustee or the beneficiaries).'[8] This decision is very important and underlines that:

- **the prorogation of jurisdiction clause binds only the settlor, the trustee(s) and the beneficiary(ies);**
- **the prorogation of jurisdiction clause does not bind a 'third party' (e.g. a 'disappointed' heir); and**
- **it will be hard for the settlor to use a non-internal trust to undermine the rights of their forced heirs.**

INHERITANCE TAX IN ITALY

The Succession Regulation does not apply to revenue matters; national law determines how taxes and other liabilities are calculated and paid.[9]

Inheritance tax (IHT) and gift tax in Italy is governed by *Decree No.346 of 31 October 1990* and *Decree No.262 of 3 October 2006* (the Decree). Italy has a worldwide tax system. Therefore, if the deceased had their last residence in Italy at the time of death, assets will be liable for IHT irrespective of where they are located. If the deceased had their last residence abroad at the time of death, only assets located in Italy will be liable to IHT. Yet we need to consider the double-taxation agreement between Italy and the UK, which was signed in 1966 and came into force in Italy in 1967.[10] Moreover, under article 26 of the Decree, even if no double-taxation agreement exists between Italy and a foreign country, if the deceased had their last residence in Italy and owns assets abroad, taxes paid in that country may be deducted from IHT due in Italy.

The Italian IHT regime is extremely favourable where succession involves the spouse and children of the deceased as heirs or legatees. The threshold under which no IHT is due is high, amounting to EUR1 million for each beneficiary. Thus, if the deceased had a spouse and two children, the threshold amounts to EUR3 million. As a result, most successions are IHT-free. In addition, if a family-run business is among the assets (e.g. the majority of company shares), under certain conditions no IHT is due, irrespective of the value.

If the value of the assets exceeds the threshold, the IHT treatment is nevertheless low, as the IHT due amounts to just 4 per cent of the value exceeding the threshold. But, as mentioned

8. *Corte di Cassazione*, 20 June 2014, no.14041

9. Article 10 of the Succession Regulation

10. *Law No.793 of 9 August 1967*

previously, this situation is rare, so succession in Italy is mostly tax-free.

The Decree also provides for succession involving other relatives of the deceased or unrelated persons as heirs or legatees. If heirs or legatees are siblings of the deceased, the threshold is reduced to EUR100,000 for each beneficiary and the IHT due if assets exceed the threshold is 6 per cent on the whole value. If they are unrelated, no threshold is provided and the IHT is 8 per cent on the whole value.

Other types of taxes are due from heirs or legatees, but only with reference to immovables bequeathed to them. These taxes are due for the registration of immovables with the Land Registry and they amount to 3 per cent, calculated and paid on the fiscal (thus not market) value of the immovables (the so-called 'cadastral value'). As this value is usually one-third (or less) of the market value, these taxes are also low. Furthermore, if an immovable is classified as a 'first home', a fixed tax of only EUR400 is due.

TRUSTS AND INHERITANCE TAX IN ITALY

IHT in Italy is due on assets held in testamentary trusts and *inter vivos* trusts. The main features of IHT treatment of trusts are as follows:

- **irrelevance of the trustee for IHT purposes;**
- **relevance of the settlor-beneficiary relationship;**
- ***inter vivos* trusts are treated as a direct gift to beneficiaries; and**
- **the IHT thresholds are applicable to trusts, so the taxation is extremely favourable.**

Consider, as an example, a matrimonial home held on trust with a fiscal value of EUR500,000. If the beneficiaries are the settlor's spouse and children:

- **no IHT is due (because the fiscal value of the home is under the threshold);**
- **taxes due for the registration of property in the Land Registry amount to 3 per cent;**
- **the increase in the trust fund value is exempted from taxes.**

Surprisingly, in Italy, any disposition of law expressly provides for the application of IHT to trusts. The rationale for the application of IHT to trusts, according to Italian tax administration interpretative documents, is that an assignment of assets to beneficiaries through a trust is, for IHT purposes, an assignment of assets as through a will or gift.

CONCLUSION

This article examines some of the myriad issues emerging from the Succession Regulation. Many of the other issues will be addressed by professionals, scholars and judges. The Succession Regulation represents a real cultural challenge for those who deal with succession planning and winding-up of estates not only in EU member states, but also in third states. These debates are just the start.

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