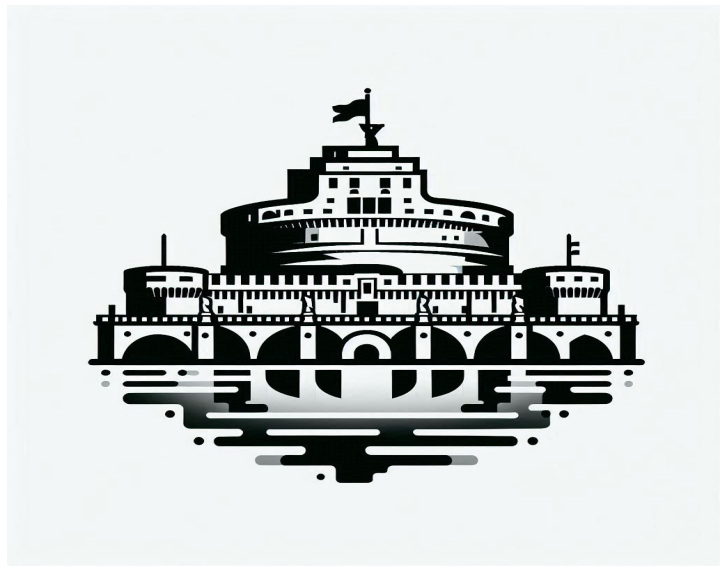


# TAXATION OF CROSS-BORDER ESTATES



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# TAXATION OF CROSS-BORDER ESTATES

## GENERAL PRINCIPLES OF TAXATION



When dealing with cross-border estates, particularly for UK citizens with property in Italy and Italians with property in the UK, several taxation-related problems can arise. These issues are distinct for estates governed by a **will** or a **trust**, and each presents its own set of challenges. Additionally, understanding the concepts of **residence** and **domicile** is crucial, as they significantly impact the tax liabilities in both the UK and Italy. Here, we will focus on the tax-related issues that specifically pertain to wills and trusts in cross-border estate planning, incorporating the influence of

residence and domicile.

### Where should tax be paid?

Before addressing the issues related to wills and trusts, it's important to understand the significance of **residence** and **domicile** in taxation.

**Residence:** Taxation based on residence primarily affects where an individual lives. In the UK, an individual's tax residence is determined by the **Statutory Residence Test (SRT)**, which considers factors like the number of days spent in the UK, ties to the country, and work or home situations. In Italy, residence is defined as spending more than 183 days in the country in a given calendar year. If a person is a tax resident in one country, their worldwide assets may be subject to inheritance tax in that jurisdiction.

**Domicile:** Domicile refers to the country where a person has their permanent home or intends to return to after a period of absence. The UK operates a **domicile-based** system for inheritance tax, meaning that a UK domiciled individual is subject to UK inheritance tax on their worldwide assets, regardless of where they reside. Conversely, Italy taxes assets located in Italy, regardless of the individual's domicile. The concepts of **domicile** and **residence** often intersect, but they determine tax liabilities in different ways.

For **Italian tax residents**, all assets, both **domestic** and **foreign**, are subject to Italian inheritance tax. This means that if an Italian citizen (or an individual who was a tax resident in Italy at the time of death) passes away, the beneficiaries will be subject to inheritance tax on all of their assets, regardless of whether the property is in Italy or abroad.

**Non-resident foreign beneficiaries** will normally be subject to Italian inheritance tax based on the value of the Italian assets they inherit.

## Dangers and Pitfalls in Estate and Trust Planning

- **Double Taxation:** One of the primary problems for individuals with property in both the UK and Italy is the risk of double taxation. A will does not always effectively mitigate this risk. In the UK, inheritance tax (IHT) is levied on the estate as a whole, with a standard rate of 40% on amounts above the £325,000 threshold. In Italy, inheritance tax is applied to the beneficiary based on the value of the inheritance they receive, with tax rates ranging from 4% to 8%, depending on the relationship between the deceased and the beneficiary. While the UK and Italy have a **Double Taxation Agreement (DTA)** to avoid double taxation, ensuring relief can be complicated. Without careful estate planning, beneficiaries may face inheritance tax liabilities in both countries, leading to a higher tax burden.
- **Inheritance Tax Liabilities Based on Domicile and Residence:** A person's **domicile** and **residence** affect where their estate is taxed. If a UK domiciled individual passes away with assets in Italy, their worldwide estate is subject to UK inheritance tax, and the beneficiaries may also face Italian inheritance tax on Italian property. The tax treatment will differ depending on the deceased's residence and domicile status at the time of death. Similarly, if an Italian domiciled person has property in the UK, their estate may be subject to UK inheritance tax, and beneficiaries will need to address Italian inheritance tax on assets located in Italy.
- **Differing Inheritance Tax Thresholds and Rates:** The UK and Italy have different inheritance tax thresholds and rates, which can lead to disparities in tax liabilities. For example, in the UK, the inheritance tax is levied on the entire estate if it exceeds the £325,000 threshold, while Italy applies inheritance tax directly to the beneficiaries based on the value of the inheritance they receive. If a UK citizen has property in Italy, the estate may face taxation at both the UK's inheritance tax rate and Italy's beneficiary-based inheritance tax, potentially leading to an excessive tax burden for beneficiaries.
- **Valuation Issues:** In cross-border estates, assets in each jurisdiction must be accurately valued according to local laws. For example, property in Italy must be valued in euros for Italian inheritance tax purposes, while UK assets will need to be valued in pounds sterling for UK inheritance tax. This difference in currency and local valuation rules can lead to complications in calculating the inheritance tax due, potentially resulting in underpayment or overpayment of taxes, as well as disputes over asset values.
- **Probate Delays and Costs:** When a will involves assets in both the UK and Italy, the probate process can be prolonged and expensive. In the UK, probate fees can be high, and the process can take several months, especially when foreign assets are involved. In Italy, probate can also be complex, particularly when dealing with property or assets that are subject to Italian inheritance tax. The probate process in both countries may require separate approvals and tax filings, leading to delays in distributing the estate and additional administrative costs.
- **Problems with Foreign Assets:** A will may not always effectively address the specific inheritance tax issues associated with foreign assets. For instance, if a UK citizen dies with property in Italy, Italian inheritance tax will apply to the beneficiary based on the value of the property they inherit, irrespective of the tax paid in the UK. Similarly, an Italian citizen owning property in the UK may face UK inheritance tax liabilities, which could be higher than expected, especially if the will does not allocate the foreign property correctly. Without proper tax planning, heirs may end up with unexpected tax burdens on foreign assets, leading to a financial disadvantage.

## Best Practices when dealing with Italy

1. **Double Taxation on Trust Assets:** Trusts can offer more control over how assets are distributed and taxed, but cross-border trusts can still be subject to taxation in both the UK and Italy. For example, if a UK-based trust holds Italian property, the trust may be liable to pay UK inheritance tax, while the beneficiaries of the trust may also face Italian inheritance tax when they inherit the property. This double taxation issue can be mitigated by careful structuring of the trust, but without proper legal advice, beneficiaries may find themselves paying taxes in both jurisdictions.
2. **Trust Taxation in the UK:** In the UK, trusts are subject to their own inheritance tax rules. While the UK has specific exemptions for certain types of trusts (such as nil-rate band discretionary trusts), the assets in a trust may be subject to inheritance tax at a rate of 40% on any value above the inheritance tax threshold. If the trust holds assets in Italy, beneficiaries may face additional inheritance tax liabilities in Italy, as the tax on the trust's distribution depends on the value of the assets inherited.
3. **Trust Taxation in Italy:** In Italy, trusts are subject to a different set of tax rules than in the UK. Trusts that hold Italian assets (such as property or bank accounts) are taxed on the value of those assets under Italian inheritance tax laws. If an Italian citizen has assets in a UK-based trust, the trust may be subject to both UK inheritance tax and Italian taxes on the assets distributed to Italian beneficiaries. The interaction between these tax systems can be complex and requires careful planning to avoid a significant tax burden.
4. **Issues with Trust Administration:** The administration of cross-border trusts can become complicated due to the differing tax laws in the UK and Italy. For instance, the trustee must ensure that the trust complies with both UK tax rules (which may apply to income and capital gains tax) and Italian inheritance tax rules (which may apply to the beneficiaries). Without proper administration, the trust could incur higher tax liabilities or administrative costs. Furthermore, if beneficiaries are located in both the UK and Italy, they may face different tax obligations based on the assets they receive from the trust, adding to the complexity of managing the trust.
5. **Beneficiary Taxation:** In a cross-border trust, beneficiaries in both the UK and Italy will be subject to local tax laws. For instance, if an Italian beneficiary receives assets from a UK-based trust, they will be subject to Italian inheritance tax on those assets, but the trust may also have to pay UK inheritance tax when it distributes the assets. Beneficiaries in the UK may face similar issues if they inherit Italian assets from a trust. Without careful planning, beneficiaries could end up paying inheritance tax in both countries, leading to unnecessary financial burdens.

## Conclusion

In summary, both wills and trusts in cross-border estate planning can present serious tax-related issues for UK citizens with property in Italy and Italians with property in the UK. The concepts of **residence** and **domicile** play a significant role in determining the tax treatment of estates, influencing where taxes are owed and the rates applied. Wills can lead to problems such as double taxation, differing inheritance tax thresholds, complications with foreign asset distribution, and delays in probate. Trusts, while offering more control, can still result in double taxation, complications with trust administration, and differences in how beneficiaries are taxed in each jurisdiction. Proper planning and legal advice are essential to mitigate these issues and ensure that the estate is administered in the most tax-efficient manner possible.