Taxation of Trusts in Israel - a refresher

A. General

1. The new laws governing the taxation of trusts in Israel are effective as of January 2006.
2. The donor/transferor of assets to the trust is considered a/the Settlor; there may be more than one Settlor.
3. Where the Settlor is a resident of Israel,then the trust will be taxable here; if non-resident(includes deceased Settlor), then the trust will not be taxed in Israel even if the beneficiaries are resident here.
4. A-4 above may not apply where a local beneficiary has effective control of the trust.
5. Where the trust is fully irrevocable/discretionary-as defined-then where all the beneficiaries are foreign,the income of the trust will not be taxable in Israel,subject to various provisos. A proposed amendment will provide for taxing only that part of the trust income that relates to Israeli-resident beneficiaries.
6. Under the law,irrevocability is essentially defined in terms of control. (see our paper on the new laws,attached.)

B. EXISTING LEGAL SITUATION

1. Worldwide income is taxable in Israel as of January 2003,under the Income Tax Reform of 2002.
2. The Income Tax Authorities consider revocable trusts(refer A-6 above) subject to tax under the "old" law-prior to 2006-as they are seen to be "transparent." There are no court nor other rulings on this and certainly the issue is not clearly defined.
3. The income tax authorities have indicated that they will examine "revocability/ irrevocability" of the trust to determine taxability prior to 2006.
4. There is a requirement since 2003 to report on awards from a trust in excess of nis100,000.

C. TAXING TRUSTS FROM 2006

1. Rates of tax on passive income will generally be 20%.
2. A proposed amendment will permit "step-up" of values at Dec 31st,2005.
3. Presumably a declaration/affidavit from the trustees that the Settlor was/is non-resident in Israel or that the beneficiaries are foreign will be sufficient.
4. The residence of the trustees will not impact on the taxability of the trust.
5. Underlying companies owning or owned by the trust will generally be treated as part of the trust structure and taxed accordingly.

D. PLANNING FOR 2006

1. Time is running out so we need to move efficiently.
2. Dissolution of existing trusts may also have tax consequences.