



TAXATION OF TRUSTS IN ISRAEL - PRELIMINARY THOUGHTS

The recent Mini Income Tax Reform has been approved by the Knesset; these laws include wide-ranging provisions for the taxation of trusts, which have implications for many taxpayers. The exclusions include trusts established by foreign settlors or grantors, both at the time of establishment and in the tax year under review, and irrevocable trusts, where the beneficiaries are non-resident in Israel.

Summarised hereunder are some of the key features of the Law governing taxation of trusts. These are summarised and, therefore, provide only part of the overall picture.

Reporting and Taxation of The Trust

The income of the trust will be subject to the Income Tax Ordinance, and taxable income will be calculated accordingly; the trust income is taxable on a current basis, irrespective of whether distributions or awards were made from the trust or not (unless specifically requested by the beneficiaries - as below). According to the law, taxes will be calculated as if the income of the trust was that of the individual settlor or grantor (individual tax rates). Personal tax credits, deductions and exemptions will not apply to trust income, unless the trust income has been distributed to a beneficiary resident in Israel and reported thereon.

The principles governing set-off of tax losses and credit for foreign taxes paid will apply to income from the trust (which is taxable, as indicated previously, on the 'individual' basis (viz. that of the grantor/settlor)).

Where the assets of the trust are held by a company, specifically established by the trust and for the purpose of holding the trust assets, these will be deemed to be the assets of the trust, and income thereon will be taxed accordingly.

Transfer of Assets to the Trust

The transfer of an asset to a trust will be deemed a sale and, therefore, a tax event. Where the transfer creates a tax loss for the grantor or settlor, such loss will not be recognised for tax purposes.

Distributions to Beneficiaries

Distributions or awards to beneficiaries of a trust, after the income has been taxed, will not be subject to tax in the hands of the beneficiary. However, where the income is distributed to a beneficiary resident in Israel within the tax year, or within six months thereafter, then such income may be taxed in the hands of the individual taxpayer and not by the trust. The new laws render this particularly complex where the beneficiary is a foreign resident.

Trust losses may not be 'distributed', but may be utilised in calculating the taxes due from the trust.



www.broide.com

Termination of Trust

On termination of the trust, the distribution of assets to the beneficiaries, where the assets arose from the capital of the trust or from income that was taxed in the trust, will not constitute a tax event (and therefore not taxable).

Unutilised losses are to be distributed on termination, in similar proportion to other distributions made to the beneficiaries during the three years prior to termination. The losses transferable are those originating from sources where the local beneficiary received the income therefrom.

Revocable Trust Definition

1. Possibility - direct or indirect - to invoke, or transfer, or return asset or income to the settlor/grantor, including spouse, minor children, estate, or holding company of settlor/grantor.
2. One or more of the beneficiaries is the settlor/grantor, or spouse, or the settlor/grantor may become beneficiaries.
3. One or more of the beneficiaries are minor children of the settlor and he/she and/or spouse are alive.
4. One or more of the beneficiaries is a corporate entity where 10% or more of the control - as defined - is held directly or indirectly by the grantor/spouse or spouse.
5. The trustee or protector is the grantor/settlor or 'holding company'.
6. The trustee or protector is a relative of the grantor/settlor, unless there is good cause for such appointment and the settlor is unable to give instructions to the trustees.
7. The grantor or relative is able to influence the activities of the trustees, or instruct them, as to the management of the trust, its assets, changes of beneficiaries, or distribution of assets or income to the beneficiaries, or his approval is required for activities of the trustees, or may change the trustees, or cancel the trust, all this directly or indirectly.
8. The identity of one or more of the beneficiaries is unknown (including shareholder in corporate beneficiary) unless there is reasonable evidence that such beneficiary cannot be the settlor, spouse, minor children or 'holding company', as defined.
9. No declaration by settlor and trustees, nor confirmation by lawyer, confirming irrevocability of trust has been submitted.
10. A change or addition was made to the beneficiaries, without specific instructions thereto in the trust documents.

Beneficiary

Entitled to benefit from the assets or income of the trust, directly or indirectly, including:

1. A beneficiary, contingent on a condition or time stipulated in the trust documents; however, where the beneficiary is contingent on the death of the grantor/settlor or other beneficiary, then as long as the latter are alive, the beneficiary will not be considered as such.
2. Unborn beneficiary.
3. Indirect beneficiary, by way of other trusts.
4. Direct or indirect shareholder in corporate beneficiary.



www.broide.com

Tax Factors

Trust income taxable as accrued, not on distribution, unless beneficiaries request to be taxed - this subject to certain conditions.

1. Top marginal rate.
2. No personal deductions or tax credits.
3. Losses cannot be utilised by settlor/beneficiary.
4. Foreign taxes set off only in trust.
5. Foreign settlor/grantor trust and foreign beneficiary trust will be treated as non-residents of Israel.

Israeli Resident Trust

At time of establishment, at least one settlor and one beneficiary were resident in Israel, and in the tax year, at least one settlor and one beneficiary are resident in Israel. Where the trust does not satisfy the 'foreign settlor/grantor' definition, it will be considered resident in Israel, and therefore taxable.

Foreign Settlor/Grantor Trust

Where the settlor/grantor is not resident in Israel at the time of formation of the trust, and during the relevant tax year, or where the settlor/grantor and the beneficiaries are non-residents of Israel during the tax year.

Foreign Beneficiary Trust

- * Irrevocable (discretionary) - see definition of 'revocable'.
- * Beneficiaries are all foreign residents and identities are known.
- * At least one settlor is resident in Israel.
- * Trust documents provide that Israeli resident cannot be beneficiary.
- * Appropriate report.

} Not Taxable



www.broide.com

Some Pertinent Comments

1. In order to make this palatable, it is extremely concise, and has excluded many, possibly pertinent, issues.
2. A settlor/grantor includes a person who has settled/granted assets to the trust.
3. Entities similar to the trust, such as foundations, establishments and such like, will be taxed as trusts.
4. Change in residence of the settlor/grantor or beneficiaries will impact directly on the taxation of the trust; new immigrant status of the beneficiary or settlor will enable reduced/exempt taxation.
5. The reporting requirements will require cooperation of the foreign trustees who have to submit the annual reports.
6. Charitable trusts may be required to register with the Registrar of Endowments in order to enjoy tax-exempt status; this may not be required where all the beneficiaries are recognised public charities.
7. Non-disclosure or insufficient information concerning the settlor/grantor or beneficiaries would appear to be disadvantageous in terms of taxability.
8. The advantages of the trust-mechanism remain intact, unless the real purpose is escaping the Income Tax cudgel.

As always, we counsel proper disclosure, careful evaluation of the post-tax reform era, and planning accordingly. There is much room for serious tax planning.

We reiterate that the above is a very brief synopsis of matters considered pertinent for most clients.

Broide & Co.
43 Emek Refaim St.
P.O.B. 8240
Jerusalem 91081
Tel: 972-2-5611323
Fax: 972-2-5669955
jeff@broide.com