

# Beneficiary of a foreign trust?

# Pay tax in Israel.

**O**n December 25, 2014, the Israel Tax Authority (the “ITA”) extended the deadline for certain reporting requirements for Foreign Settlor Trusts in Israel. The previous deadline which was December 31, 2014, has now been extended to June 30, 2015. Following a major reform to Israeli tax law in August, 2013, a Foreign Settlor Trust is suddenly taxable in Israel if one of the beneficiaries is an Israeli tax resident.

Under prior law, a trust settled by a foreign resident was exempt from tax and reporting in Israel on non-Israeli source income. Under the new law, a trust is subject to tax in Israel even if there is only a single Israeli resident beneficiary. Such a trust is now known as an Israeli Beneficiary Trust and the beneficiary will have to pay tax on the distribution or income which is allocated to him or her.

## Israeli Beneficiary Trust

An Israeli Beneficiary Trust is subject to Israeli taxation regardless of its revocability if the following three conditions apply:

1. The settlor is alive and is a non-Israeli resident. A settlor will be deemed alive as long as the settlor’s spouse is alive on the condition that the couple was married at the time a transfer was made to the trust.
2. The trust has at least one Israeli resident beneficiary.
3. The settlor and the Israeli beneficiaries are relatives. Parents, children, spouses and grandchildren are automatically considered relatives. In other cases such as brothers, nephews and aunts, such persons are considered relatives only to the extent that the tax officer is convinced that the trust is created in good faith and the beneficiary has not paid any consideration for his right in the trust’s assets.

If the settlor has died, or is deemed not to be related to the beneficiary, the trust will be subject to tax in Israel on its worldwide income.

## Israeli Beneficiary Trust - Tax Regimes

An Israeli Beneficiary Trust is taxed under one of the following two options:

1. 30% Tax Regime – under the 30% Tax Regime, the yearly income of the trust will not be subject to tax in Israel. However, a distribution to an Israeli resident beneficiary will be taxed in Israel at a rate of 30%, unless the trustee proves that he distributed assets that were originally granted to the trust by the settlor. This is the default tax regime.
2. 25% Tax Regime — A trust may elect to be taxed at a rate of 25% on a yearly basis, with respect to the portion of the trust’s income which is allocated to an Israeli beneficiary. If such an election is made, any future distributions will be exempt from

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tax. The trustee must submit a one time, irrevocable election to choose this option.

In addition, the trustee is required to submit a one-time notification of the existence of a trust to the ITA within 60 days of its formation or attaining its status or in the case of existing trusts, until June 30, 2015.

## Taxation of Trusts settled by Olim

Trusts that were settled by olim who arrive in Israel after August 1, 2013, will be entitled to the benefits of new immigrants or senior returning residents only if all beneficiaries of the trust are new immigrants or foreign residents, and as long as the settlor is still alive. For those settlors who made Aliyah before August 1, 2013, the trust will remain tax exempt for as long as the settlor is alive and up to the ten year tax exemption which the settlor is entitled to.

## Arrangements with the ITA

The ITA offers an amnesty program for the years 2006-2013 for trusts looking to either find closure on the possibility of past tax liabilities or that are interested in receiving a step-up in the cost basis of the trust’s assets to the fair market value at the time the trust became subject to Israeli taxation.

To qualify for a settlement (3- 6% of the trust’s asset value at the end of 2013 or 1/3- 2/3 of the income tax due between 2006-2013) the Israeli-resident beneficiary must not have transferred any assets to the trust and the trust assets cannot be derived from taxable income in Israel on which taxes were not paid.

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*Dave Wolf & Co. is a law firm specializing in taxation and wealth management with offices in Jerusalem, Tel-Aviv and New York and affiliate offices in Greater China, London and Amsterdam.*

The content of this article is intended to provide a general guide to the subject matter and **is not a substitute for legal consultation**. Specific legal advice should be sought in accordance with the particular circumstances.