

WHAT THE NEW TAX REGIME MEANS FOR NON-ISRAELI TRUSTS WITH ISRAELI BENEFICIARIES

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ISSUES

- **2006 - The Taxation of Trusts in Israel**
- **2014 - ITO Amendment 197**
- **Reporting**

New provisions for Taxation of Trusts in Israel – 2006

- New legislation regarding the taxation of trusts took effect in Israel.
- Types of Trusts:
 - Foreign Settlor Trust (FST)
 - Foreign Beneficiary Trust (FBT)
 - Israeli Residents Trust (IRT)
 - Testamentary Trust (TT)

Foreign Settlor Trust (FST)

At the time of its establishment **and** in the relevant tax year, all the grantors were non-residents

OR:

In the relevant tax year all of the grantors and all of the beneficiaries are non-residents.

A deceased settlor is considered to be a foreign settlor, if he is a foreign resident at the time of his demise

Taxation –

FST is subject to tax as a non-Israeli resident, i.e. only on Israeli sourced income.

Foreign Beneficiary Trust (FBT)

An irrevocable trust;

AND

its beneficiaries are individual foreign residents, whose identity is known;

AND

at least one of its settlors is an Israeli resident.

Taxation –

FBT is subject to tax as a non-Israeli resident, i.e. only on Israeli sourced income.

Israeli Resident Trust (IRT)

At the time of its creation at least one settlor and at least one beneficiary were Israeli residents

AND

at least one settlor and at least one beneficiary thereof were Israeli residents in the tax year

OR

A trust that is not a FST and not a FBT

Israeli Resident Trust (IRT)

Taxation –

IRT is subject to tax as an Israeli resident, i.e. on its world-wide income

Testamentary Trust (TT)

The trust was settled under a will

AND

All settlors of the trust are testators who were Israeli residents at the time of their demise.

Taxation –

If all the beneficiaries are non-Israeli residents, TT is subject to tax as a foreign resident

If one of the beneficiaries is an Israeli resident, TT is subject to tax as an Israeli resident, i.e. on its world-wide income.

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2014 - ITO Amendment

197 - Taxation of Trusts

- Significant amendments were made to the provisions dealing with the taxation of trusts as of January 1, 2014
- Cancellation of the FST regime
- Reclassification of former FST's to one of the following types of trusts:
 - Israeli Residents Trust (IRT)
 - Non-Resident Beneficiary Trust (NBT)
 - Relatives Trust

Israeli Beneficiary Trust (IBT)

From the time of settlement until the tax year in question all the grantors are non-residents

AND

In the tax year in question there is at least one Israeli-resident beneficiary.

a “Public Interest Beneficiary” will not be considered a beneficiary.

Relatives Trust

IBT which meets the following additional conditions:

Between each grantor and each beneficiary there exists the required family relationship (as defined in the law)

AND

The grantor or the grantor's spouse, is still alive in the tax year in question

AND

Notification as required by law is made in timely fashion

Relatives Trust

Taxation –

Default - 30% tax rate on distribution of non Israeli sourced income

- As for Distribution of principal, if the distribution is of an asset that was transferred to the trustee, and if it was transferred directly from the settlor to the beneficiary, then if that transfer was exempt, the distribution will be exempt
- distribution of income prior to distribution of principal
- the distribution is proportional to each beneficiary's share of the trust

Relatives Trust

Taxation –

Election - 25% tax rate on current non Israeli sourced income

- Election should be within 60 days since establishment of trust or classification as a Relatives Trust.
- The election is irrevocable as long as the trust remains a Relatives Trust.
- Distribution up to the income taxed at a 25% tax rate, is exempt from tax.
- Profits accumulated until 31.12.2013?

Relatives Trust

Taxation –

- Transfer of assets from settlor to trustee will be treated as if the asset had been transferred directly from the settlor to the beneficiaries
- Current income/capital gains of the trustee are taxed as an Income of a foreign resident individual
- Israeli sourced income of trustee is taxable in the relevant tax year it is earned and at top marginal tax rate (except for special tax rates)
- A notice regarding the establishment of a Relatives Trust should be filed within 60 days of its establishment
- Transitional provisions – ITA Guidance

Relatives Trust

Taxation – New Immigrants

- If one of the beneficiaries of the trust is entitled to New Immigrant tax benefits, a portion of the trust's income allocable to the New Immigrant beneficiary will also be entitled to the same tax benefits for the same duration
- If the Relatives Trust is reclassified as an Israeli Residents Trust, due to the death of the settlor and his/her spouse, then the portion of the trust's income allocable to the New Immigrant beneficiary will still be entitled to New Immigrant tax benefits for the same duration of time as that beneficiary.

Foreign Residents Trust

During the relevant tax year all settlors and all beneficiaries are foreign residents

OR

During the relevant tax year all settlors are foreign residents and all beneficiaries are Public Interest Beneficiaries or foreign resident beneficiaries, and the trust never had any Israeli resident beneficiaries since its establishment

OR

All the settlors are deceased and during the relevant tax year all beneficiaries are foreign residents

OR

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Foreign Residents Trust

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OR

All the settlors are deceased and during the relevant tax year all beneficiaries are Public Interest Beneficiaries or foreign resident beneficiaries, and the trust never had any Israeli resident beneficiaries since its establishment

Taxation –

A Foreign Residents Trust is considered to be a foreign resident

Reporting

- A beneficiary that received a distribution from a trust is obliged to report it and file an annual tax return, even if the distribution is exempt from tax, unless it is a distribution of an asset outside of Israel to a beneficiary of a:
 - Foreign Residents Trust
 - Foreign Resident Beneficiary Trust
 - Testamentary Trust all of whose beneficiaries are foreign residents
- Form 1301 was changed to require specific reporting on distributions received from trusts
- A trustee of a Relatives Trust that elected to be taxed on current income is required to file an annual tax return

Thank You

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