



Legal Update

July 2015

FBC Tax Department

Important update - the Israeli Tax Authority has extended to December 31, 2015 the date for the reporting of an existing Relatives Trust and for requesting application of the transitional arrangements to an Israeli Beneficiary Trust

Dear Clients and Colleagues,

In our previous circulars, we described recently enacted reforms to the taxation of trusts in Israel (the "**Amendment**"), effective from January 1, 2014.

The Amendment, inter alia, established two new categories of trusts under Israeli law:

1. An "**Israeli Beneficiary Trust**," which is a trust established by a foreign resident who continued to be a foreign resident from the date of its establishment until the relevant tax year, and which has at least one Israeli beneficiary.
2. A "**Relatives Trust**," which is an Israeli Beneficiary Trust that fulfills the following conditions: (i) the settlor is the beneficiary's parent, grandparent, spouse, child or grandchild. If the settlor and the beneficiaries are relatives of second degree (including, inter alia, siblings, siblings' issues, parents' siblings, spouse's issue), then in order for the trust to qualify as a Relatives Trust the Israeli assessing officer must confirm that the trust was established, and any contribution to it was made, in good faith and that the beneficiary did not pay any consideration in order to be entitled to the trust's assets; and (ii) the settlor of the trust is still alive in the relevant tax year.

Relatives Trust

The Amendment establishes two alternative tax regimes for the taxation of a Relatives Trust:

- (a) **30% tax regime**- The Israeli beneficiary will be subject to Israeli tax at a rate of 30% on a distribution that is sourced from income generated and produced outside Israel, unless it is otherwise proven that the trustee distributed principal of the

trust, in which case the distribution will be tax-exempt; or

- (b) **25% tax regime**- Instead of the beneficiary being taxed on the distributions, the trustee may elect (with irrevocable effect) that the portion of the income of the trust attributable to the Israeli beneficiary that is generated or produced outside Israel will be taxed to the beneficiary at a rate of 25% in the year in which such income was generated or produced. If such an election is made, the distributions to the Israeli beneficiary, when actually made, up to the amount of income taxed at a 25% tax rate, will not be subject to further Israeli tax.

Recently the Israeli Tax Authority (the "ITA") further extended the date for the reporting of an existing Relatives Trust to **December 31, 2015** (the previous deadline was June 30, 2015).

This reporting includes:

- (i) Notification of the existence of a Relatives Trust;
- (ii) Notification for election of the tax regime to which the trust will be subject (i.e., either 25% tax regime or 30% tax regime) (the "**Notifications**").

If no such election is made, then the default tax regime will be the 30% tax on income when it is distributed.

We therefore recommend that trustees and stakeholders in Relatives Trusts complete the required analysis and prepare the Notifications by December 31, 2015 in order to elect (with irrevocable effect) the tax regime to which the trust will be subject.

Israeli Beneficiary Trust

On March 9, 2014 the ITA published transitional arrangements concerning the 2006–2013 tax years with regard to the taxation of trusts on whose management an Israeli beneficiary has or had a measure of influence (the "**Guidelines**").

In general, the ITA's Guidelines offer trustees the option of choosing among the following three tax tracks:

- (a) **The "Income Track"**- Under the Income Track, a trust is subject to Israeli tax on 1/3, 1/2 or 2/3 of its income generated during the years 2006-2013 (depending on certain criteria aimed at identifying the beneficiary's potential to influence the management of the trust) (the "Taxable Portion of the Trust Income"). Generally, the trustee will not be afforded a stepped-up basis in the trust's assets upon the sale of such assets in the future. However, if the trustee elects to pay tax on the deemed sale of the trust's assets in accordance with their value on December 31, 2013, then the trust's assets will be given a stepped-up basis as of that date. In this regard, the trustee will be permitted to set-off foreign taxes that will actually be paid, but only with respect to the Taxable Portion of the Trust Income
- (b) **The "Capital Track"**- In certain circumstances, where the return on the trust's capital is "not unusual", the trustee may ask the assessing officer to tax the trust's capital (rather than the trust's income as under the Income Track).

Under the Capital Track, the trust's assets will be afforded a stepped-up basis, such that the assets will be deemed sold on December 31, 2013 and their new cost basis will be determined in accordance with the asset value on such date. The applicable tax rate will be 3%, 4% or 6% (depending on certain criteria aimed at identifying the beneficiary's potential to influence the management of the trust).

- (c) **The no-tax track**- This track will apply only to trusts that, in the assessing officer's view, were not subject to the influence (or the ability to influence) of the Israeli beneficiary. In such a case, the trust's assets may be afforded a stepped-up basis as of January 1, 2014 and no tax will apply to the trust's assets and income. In general, this track will be applicable if the settlor was a foreign resident and was alive during the years 2006-2013, and either (i) all the beneficiaries were minors who are residents of Israel, or (ii) the percentage of beneficiaries who are residents of Israel is lower than 10%.

Recently the ITA extended the deadline to apply for the transitional arrangements and, therefore, trustees who wish to have the transitional arrangements apply to them are required to file a request with the ITA by December 31, 2015.

Sincerely,

**FBC Tax Department
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