

## **General review of Taxation of Trusts in Israel**

### **Introduction**

As of January 1st 2006, a significant Israeli tax reform with respect to taxation of trusts came into effect (the: "**Trust Regime**").

The Trust Regime, as set forth in Chapter Four 2 of the Israeli Income Tax Ordinance (New Version), 1961-5721 (the "**Ordinance**"), generally distinguishes between several kinds of trusts, namely: (i) an Israeli Resident Settlor Trust ("**IRST**"); (ii) a Foreign Resident Settlor Trust ("**FRST**"); (iii) a Foreign Resident Beneficiary Trust ("**FRBT**"); and (iv) a Testamentary Trust.

The following provides a short summary of the different tax aspects in each kind of trust:

### **IRST**

In general, if the Settlor (the grantor) of the trust is a resident of Israel, and in addition at least one of the beneficiaries of the trust is an Israeli resident, the trust will be classified as an Israeli Resident Settlor Trust ("**IRST**"). Under such classification, all of the income of the trust will be classified by default as the Settlor's income. As such, the trust's income will be taxable in Israel and will be subject to the Israeli Trust Regime.

According to section 75G(g) of the Ordinance, under certain conditions, the abovementioned trust income will not be treated as the Settlor's income but rather as the beneficiary's income.

According to section 75G(h)(1) of the Ordinance, the Settlor in an **IRST** has a liability to file an annual tax return with regards to the trust's income.

### **FRST**

In the event that the trust is formed by a non resident of Israel, the trust will be classified as a Foreign Resident Settlor Trust ("**FRST**"). In such event, the income of the FRST, and the distributions from the trust to the beneficiaries are not subject to tax in Israel provided that such income is not derived from Israeli sources, and the assets are located outside of Israel. Furthermore, according to Section 75I(a) of the Ordinance it can be inferred that as long as the Settlor of the trust remains a non Israeli resident, the trust is considered as a Foreign Resident Settlor Trust and its income is not subject to Israeli tax.

The Ordinance further provides in Section 75I(c) that a **FRST** shall be considered as foreign resident, and accordingly the assets of such trust shall be deemed as being held by a foreign resident, and its income as the income of a non Israeli individual settlor.

Therefore, the determination of who is the settlor of the trust, and what is his residency, is crucial for the classification of the trust as **FRST**.

The term "settlor" as defined in Section 75D(a) of the Ordinance is defined broadly and includes, among others, beneficiaries that have the ability to control or influence, directly or indirectly, the management of the trust, the trust's assets, appointment and/or designation of beneficiaries, appointment or replacement of trustees or any influence or control of the trustee or with respect to the distribution of assets or incomes from the trust. The term "settlor" also includes, among others, shareholders or persons of a foreign company or entities which set up the trusts.

In addition, it should be noticed that, the status and the classification of the trust according to the Tax Regime, and including with respect to **FRST**, are examined on a yearly basis. Therefore, as can be inferred from the above, any future change, such as, the named beneficiaries and/or the identity of settlor (i.e. contribution of new assets to the trust by new settlor) and/or the assets and/or income of the trust (such as from Israeli sources) may change the classification of the Trust for Israeli tax purposes.

Generally, Trustee of a **FRST** does not have an obligation to file tax returns or reports with the Israeli Tax Authority if the income is not derived from Israeli sources, and the assets are located outside of Israel.

In case that an asset of the trust is located in Israel or income is derived from Israeli sources, then an obligation by trustee to file a tax return regarding such assets and/or income exists.

### **FRBT**

A Foreign Resident Beneficiary Trust (**FRBT**) is a trust which satisfies all the conditions of section 75J(a) of the Ordinance. Among the different conditions, in order for the trust to be a FRBT, it should be:

- Irrevocable
- All its beneficiaries should be foreign individuals of which identity is known
- At least one Settlor should be an Israeli resident
- It was specifically determined in its documentation that Israeli residents should not be added as beneficiaries

In case a trust is classified as a Foreign Resident Beneficiary Trust (**FRBT**), Section 75J(b) of the Ordinance provides that the income and the assets of the trust shall be treated as the income and the assets of the beneficiary.

The Ordinance further provides in Section 75J(c) that a **FRBT** shall be considered as a foreign resident, and accordingly the assets of such trust shall be deemed as being held by a foreign resident, and its income as an the income of a non Israeli individual.

In addition, according to section 75J(d) of the Ordinance, the transfer of assets into a **FRBT** should have the same tax treatment as if the assets were transferred directly from the Settlor to the foreign resident beneficiary.

### **The Testamentary Trust**

According to section 75L(a) of the Ordinance, a Testamentary Trust is a trust created according to a testament, and in which all the Settlers are testamentors who were Israeli residents on the date of their demise.

In a Testamentary Trust, Section 75L(b) of the Ordinance provides that the income and the assets of the trust shall be treated as the income and the assets of the beneficiary.

According to section 75L(c) of the Ordinance, in case there is at least one beneficiary who is an Israeli resident in a Testamentary Trust, the trust should be considered as an **IRST** and the income and the assets of the trust shall be treated as the income and the assets held by an Israeli resident. In addition the reporting liabilities of the trust in such case should be the same reporting obligations of the **IRST**, as mentioned above and subject to certain regulations.

In case, there is no beneficiary who is an Israeli resident in a Testamentary Trust, the trust should be classified as a foreign resident and its income and assets shall be treated as income and assets of the beneficiary. In such case the reporting obligations should be examined in accordance with the obligations related to a foreign resident (**FRBT**).

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We will be happy to further assist with these matters.

Sincerely,

**Meori Ampeli, ADV. (CPA)**