

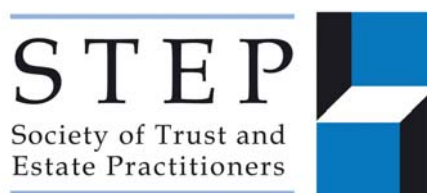
# Addendum to The Guide to the Israeli Taxation of Trusts

Prepared for clients and prospective clients of  
Anglo Capital Limited.



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**Jerusalem Branch**

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29<sup>th</sup> October 2009

# Addendum to The Guide to the Israeli Taxation of Offshore Trusts

## **A summary of Israeli tax information**

This is a of unofficial & non-binding translation of a document originally published in Hebrew and is based on our understanding of Israeli law, legislative proposals and current practice as at October 2009.

This guide is intended to provide a general guide to the subject matter and should not be regarded as a basis for ascertaining the liability to tax or legal opinion in specific circumstances.

In such instances, separate advice should be taken.

The Guide to the Israeli Taxation of Offshore Trusts can be found on the Anglo Capital Limited website at: [www.anglocapital.com](http://www.anglocapital.com)

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**Unofficial Translation of the Document issued on the 26<sup>th</sup> October 2009 by  
THE STATE OF ISRAEL – MINISTRY OF FINANCE**

**Judicial Office**

Date: 26 October 2009

**To: Assessment Officers**

**Topic: Tax Authority's Position Regarding Various Topics Dealing with Trusts**

Recently, the Director of the Tax Authority received various appeals from trustees and presenters associated with trusts. The clarifications delineated below were established following professional and judicial examination of topics within the tax authority and subsequent to deliberations with attorneys and accountants dealing in these matters.

In light of the clarifications appearing below, the Director of the Tax Authority decided to extend presentation of reporting of trusts until 31 December 2009.

Below is the Tax Authority's position regarding the following issues:

**1. Beneficiaries Reporting of Trusts for Tax Years 2002-2005:**

1.1 Chapter Four 2 of the Income Tax Ordinance (hereafter – “**Trust Chapter**”), as per the version following amendment 165 of the ordinance, established that an Israeli resident beneficiary receiving a trust distribution that is not in cash, shall present a notification only (as opposed to an annual report). The coming into effect of this edict that is in paragraph 75P3 of the trust chapter (added in amendment 165 of the ordinance), regarding distributions from 1 January 2006 and onwards.

In the framework of the publication of these forms relating to reporting of trusts, Form 149 was published (A notification of distribution that was received by a beneficiary on the tax year) that was designed to report such a distribution.

1.2 The aforementioned paragraph 75P3 actually replaced a broader directive established within the framework addition of the trust chapter in amendment 147 of the ordinance, paragraph 131(a) (5b), that determined the incumbency of the beneficiary receiving trust distribution to present annual reports itemizing details of the asset or income distributed to him.

1.3 Transient to the addition of the trust chapter within the framework of amendment 147 of the ordinance, paragraph 131(a)(5b) of the ordinance, that established in addition within the framework of amendment 132 of the ordinance (in its previous version prior to amendment 147 of the ordinance), with the coming into effect of 2002 reports and following:

**“An Israeli resident who created a trust during the tax year, or received from fiduciary money an amount reaching 100,000 NIS, and anyone who is a beneficiary of trust money, benefited from them or entitled to them, directly or indirectly, even if they are not liable by Israeli tax”**

- 1.4 According to the assessments, many beneficiaries did not report for years 2002 through 2005, either because the version of paragraph 131(a)(5b) was not clear (the version during that period) or due to general lack of clarity of the tax authority's position regarding anything relating to trusts and reporting regarding them.
- 1.5 In light of the aforementioned, and due to the fact that the type of reporting required today from a beneficiary of a trust is notification alone, it has been decided that:
- 1.5.1 An Israeli resident beneficiary receiving trust distribution of any type (including a cash distribution) and of any amount, even if not liable for taxes in Israel, during the years 2002 through 2005, and has yet to submit an annual report in this regard, will report on those distributions during the period that was set for the reporting of trusts, subject to the extension granted by the Director of the Tax Authority, meaning until 31<sup>st</sup> December 2009.
- 1.5.2 The report can be given as an annual report presented by the beneficiary (if he is required to present without any connection to reporting requirement on the dispersal or that he opts to do this) or with form 149, within the appropriate fields for the aforementioned details with hand-marked demarcation at the top of the form that this report is for distributions for tax years 2002-2005.
- 1.5.3 It is understood that the aforementioned leniency does not apply to a beneficiary that was required to report annually as per paragraph 131 of the ordinance, not as required of a beneficiary as per 131(a) (5b), and he did not submit. That same individual continues to be required to present annual reports for those tax years and the same directives still apply in this matter, including sanctions established for not reporting.
- 1.6 The clarification given regarding beneficiaries for years 2002-2005, will be brought into the directive regarding trust reporting that will be published soon.

## **2. Non Applicability of the Chapter on Trusts in a Case of Agency**

- 2.1. The version of the trust chapter is wide and includes and apparently absorbs within it almost every type of arrangement or legal relationship in which is involved a trustee or other person whose role it is to act for the benefit of another.
- 2.2. Clause 75 (17) of the ordinance includes a list of specific circumstances in which the instructions in the chapter on trusts do not apply in respect of those cases that are listed (for example a "kupat gemel" - provident fund, "hekdesch" – endowment fund, a trust that guarantees the existence of debt, etc).  
In addition to this, there are further cases that are not listed in the said clause, that are not in the definition of "trust" as defined in the trust chapter and therefore, in those cases too, the regulations of the trust chapter will not apply.
- 2.3. The regulations in the trust chapter will not apply in cases of "Agency" according to its meaning in the Law of Agency – 1965. It is possible to differentiate between a trust (which is dealt with in the trust chapter) and an agency, within the essential differences that generally exist between them, including:
- 2.3.1 In an agency, the assets belong to the principal whereas in a trust, the trustee is the formal owner of the assets;
- 2.3.2 An agent is authorized to perform only legal actions for the principal and his acts obligate and benefit the principal (sometimes

including criminal liability); whereas the trustee ought to act independently as the person in control of the asset and the settlor is not responsible for his actions. The agent is bound to act according to the instructions of his principal and is not authorized to exercise discretion if he did not expressly receive this authority, whereas the trustee is obligated to exercise his discretion and to act independently;

2.3.3 The agent is obligated to his principal whereas the trustee is obligated to act for the benefit of the beneficiaries;

2.3.4 The agent is bound by the instructions of the principal who is authorized to change them or to cancel the agency at any time, whereas the trustee is not obligated by the instructions or directions of the settlor which do not appear in the trust deed.

2.3.5 The death of the principal or the agent brings the agency to an end, whereas the death of the settlor or the trustee will not necessarily lead to the end of the trust (the trustee will be replaced by another).

Thus for example, a person (individual or group of individuals) appointed to manage a bank account on behalf of the owner of the account, will be regarded as the agent of the account owner (even if he has signing power on the bank account), if he acts or is authorized to act only according to the directions and authorization of the account owner (excluding the performance of technical actions or urgent and obligatory actions); his actions obligate and benefit the account owner; he owes a debt of trust to him; the account owner is permitted to stop his activity at any time; et al.

Contrary to that, in circumstances where the said person is authorized to act independently in the management of the bank account and according to his discretion, the instructions of the trust chapter will apply. In this case, there is no difference if the account is to be on the name of the agent, or not.

2.4. Expansion on the topic of non applicability of the trust chapter in certain cases (including agency and rights to property), will be provided in the professional circular dealing with taxation of trusts that will be published soon.

### **3. Change in the nature of taxation of past trust income**

3.1 In June 2008, the method for the taxation of income from trusts established prior to 1<sup>st</sup> January 2006 that was generated or earned until that time, was publicized, In light of the extension granted by the Director of the Tax Authority, as above, the final time set for the submission of requests for the settlement of tax arrangements is extended until 31<sup>st</sup> December 2009.

3.2 One of the problems raised, as above, relates to the devaluation of assets beginning 31<sup>st</sup> December 2005, which was the cut-off date according to which the “Step-Up” in the tax value arrangement was implemented (“The determined time”), until the present time. Therefore, the Director of the Tax Authority has decided to implement a change to the tax value as it relates to this matter, as per the choice of the Trustee or representative, as follows:

A. As an alternative option for the determination of the value of “Trust Capital” at the determined time as determined according to the tax value, it will be possible to choose, for specific assets (“the chosen asset”), the method by which the chosen asset will be taxed at the time

of disposal. The proceeds from disposal shall be apportioned on a linear basis at the time of disposal.

The portion of the proceeds accumulated up to the determined time shall be taxed according to the tax rates in the tax marker. The balance of the proceeds (which is the portion accumulated after the determined time) shall be taxed according to the directives of the chapter on trusts.

- B. According to this principle, the proceeds (not profit) of an asset sold in the future shall be divided on a linear basis into two periods with the relevant taxation as detailed above.
- C. The period available to the tax-payer in which to sell the asset will be limited and this will be until 31<sup>st</sup> December 2011. If by the end of this period the chosen asset has not been sold, a conceptual sale mechanism shall be applied and the taxation shall be according to Sub Par. A. and B. above, as if the asset had been sold (i.e. linear division and taxation according to the two tax rules.) It is the responsibility of the Trustee to provide a valuation of the asset at that time.

#### **4. Clarification of the Conversion of Transactions with Exchange Rates**

- 4.1 A trustee of an Israeli resident trust, according to Par. 75G of the Act, or a trustee as per an Israeli resident will, according to Par. 75L(c) (1) of the Act, that generated or earned income outside of Israel, is required to report such foreign income converted to New Israeli Shekels according to the rules of the Income Tax Authority (conversion to New Israeli Shekels of amounts whose source is outside of Israel), 2003. (“Rules of Conversion”)
- 4.2 According to the rules of conversion, there are some transactions or income that shall be converted to New Israeli Shekels at the representative rate on the day of the payment or on the day of the transaction, according to the matter, and there are some transactions and income that shall be converted to New Israeli Shekels at the representative rate at the end of the reporting tax year.  
This requires the income producer (the trustee of the same trust) to prepare while it is still time to interpret the income emanating from those same activities, according to correct exchange rates, including bookkeeping system adjustment as per conversion principles.
- 4.3 Trust reports must be presented at the end of the extension provided by the Director of the Tax Authority, namely reports for tax years 2006, 2007 and 2008. In addition, the 2009 report should be presented within the legal period of the 2010 tax year.
- 4.4 In light of the extension granted by the Director of the Tax Authority for presenting trust reports, including annual reports, because of the difficulty bound in the post factum translation of activities and transactions during the years that transpired and from the desire to relieve the trustee community (including foreign trustees) to uphold their requirement for report presentation, it has been decided to allow the trustees to present the annual reports for years 2002-2005, when all foreign income included in those reports to be converted using only the representative rate of the relevant currency at the end of the tax year.
- 4.5 Annual reports for the tax year 2010 and onwards will be presented according to law established in the ordinance and its amendments, including principals of conversion.

Sincerely,

Moshe Mizrachi, J.D. (C.P.A.)  
Tax Authority Judicial Advisor