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TAXATION OF TRUSTS IN ISRAEL – Brief Memo

A. Classification of Trusts

1. The Laws governing taxation of trusts in Israel came into effect as of January 2006. Recent legislation – effective as of 2014 – now includes the taxation of foreign-settled trusts in Israel.
2. The donor/transferor of assets to the trust is also considered a settlor/grantor. There may be more than one settlor/grantor. The definition includes a beneficiary where able to exercise direct or indirect control of the trust.
3. Where the trust has Israel-resident beneficiaries, it will be taxable in Israel, subject to certain exceptions.
4. A family trust (close family relationship between settlor/grantor and beneficiaries) is defined in the Law and is also conditional on the settlor or spouse being alive.
5. Where the trust is fully irrevocable/discretionary – as defined – then where all the beneficiaries are foreign, the income of the trust will not be taxable in Israel, subject to various conditions. There is a provision for taxing only that part of the trust income that relates to Israel-resident beneficiaries.
6. On the death of the settlor/grantor, where there is an Israel-resident beneficiary, the trust will be considered an Israel-resident trust.
7. A trust settled by a new immigrant/resident is entitled to certain Income Tax benefits (“the 10-year tax holiday”) available to the settlor; new residents who became resident from August 1, 2013, will be subject to certain limitations.

B. Income Tax Factors

1. Rates of tax on passive income will generally be 25%.
2. Trustees of family trusts (see A4 above) may elect to be taxed at 25% of the taxable income of the trust or 30% on distributions (with allowance for neutralizing the capital contributed). This election is not reversible.
3. The residence of the trustees will not impact on the taxability of the trust.

B. Income Tax Factors (cont'd)

4. Underlying companies, (holding trust assets and owned by the trust), will generally be treated as part of the trust structure and taxed accordingly (subject to certain conditions).
5. Dissolution of existing trusts may have tax consequences.
6. Beneficiaries are required to report on distributions received in kind or cash, and irrespective of whether taxable.

C. General

1. It should be noted that certain by-laws, ITA directives and new forms have yet to be published; these may impact materially.
2. An arrangement, whereby a trustee holds assets for a beneficiary, may be defined as a trust, even where not formally established under Trust Law, locally or abroad.
3. Under certain conditions, the settlor/grantor may report to the Tax Authority (and thus be the taxable entity) and not the trustees.
4. Where the beneficiaries of a foreign-settled charitable trust are public institutions – as defined – then they will retain their foreign status.

This is a very brief synopsis of the Tax Laws pertaining to taxation of trusts in Israel, and is intended for reference only. The original Law in Hebrew is the final and authoritative basis for making decisions.

Whilst every care has been taken in compilation, no responsibility can be accepted for inaccuracies or errors. Changes in the Law or practice occur periodically; it is recommended that specific professional advice be sought before any action is taken.

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