

Law Report: Israel Keeps Up with Worldwide Trend of Information Exchange and Tax Collection

I. Introduction

Many countries, especially members of the G20, have agreed to cooperate in the areas of information exchange and tax collection. Legislation has been passed to this effect, including FATCA in the United States and similar laws in the United Kingdom and other countries. Israel is part of this worldwide movement toward transparency and cooperation. In the summer of 2013, the Israeli Knesset (parliament) passed the Law for the Change of National Priorities (commonly known as the "Arrangements Law"). The Arrangements Law amended various laws, including the taxation of trusts legislation. In addition, the Tax Authority published a Voluntary Disclosure Procedure in September 2014 in an attempt to collect taxes from undeclared assets owned by Israeli residents.

This report summarizes the amendments contained in the Arrangements Law as they relate to the taxation of trusts and the requirements of filing tax reports by trustees, as well as the voluntary disclosure program.

II. Taxation of Trusts

Prior to the enactment of the Arrangements Law, a certain trust categorization permitted a reporting and tax exemption in Israel with no time limit: this was known as a "foreign settlor trust." The main requirements were: (i) the settlor's residence be abroad; and (ii) the location of the assets and income be abroad. This benefited mainly Israeli beneficiaries whose family members abroad settled trusts for their benefit that remained tax free in Israel.

The Arrangements Law abolished this foreign settlor trust category. Such trusts settled by non-residents for the benefit of Israeli resident beneficiaries are now defined, pursuant to the Arrangements Law, as Israeli resident beneficiary trusts and the trustee is now obliged to file annual tax reports. The requirements for this categorization include an immediate family relationship between settlor and beneficiaries ("Family Trust") and the settlor remaining alive in the relevant tax year. Where a trust does not qualify as a Family Trust, it will be categorized as an Israeli resident's trust and taxed on its worldwide income at the rates applicable to individuals.

The Family Trust is taxed in one of two ways:

- Distributions to beneficiaries are taxed at the rate of thirty percent of the distribution amount unless the trustee provides evidence of income and principal portions of the distribution. Distributions solely of principal are not taxable. While evidence of principal and interest distributions may be complicated,

it is more likely that distributions will be taxed at thirty percent of the distributed amount.

- The trustee may choose to file annual reports and pay tax annually at the rate of twenty-five percent on income accrued annually. This option requires the preparation of balance sheets, annual reporting and annual tax payments on realized gains. Upon the filing of annual returns and the payment of the relevant taxes, distributions to beneficiaries are not taxable. This route, once chosen by the trustee, is irreversible.

The new law came into force on 1 January 2014. The law provided an extension of time for filing reports of trustees until June 2015.

III. Voluntary Disclosure

A new voluntary disclosure procedure, published in September 2014, applies to undeclared assets and income held abroad by Israeli resident individuals. It includes three options: a standard voluntary disclosure procedure; a fast track procedure; and an anonymous procedure.

The two latter options are available under a temporary order valid for a period of one year, up to September 2015.

All procedures require the submission of an application that includes all factual information, including sources of income, relevant tax years and estimates of taxes owed. None of the procedures relieve the taxpayer from the payment of interest, index linkage payments or civil fines. Upon payment of all sums owed, no criminal proceedings will be commenced against the applicant.

Applications will be approved only if the Tax Authority (or any other governmental agency) does not possess any prior information relating to the applicant, the applicant's spouse, the applicant's company or business partners.

The fast track procedure may be chosen where the total amount of the undeclared funds does not exceed two million shekels (approximately US \$500,000) and the taxable income does not exceed 500,000 shekels (approximately US \$140,000) in the reporting year. Anonymous applications may not be submitted under the fast track option.

The anonymous procedure permits the submission of anonymous applications in which all other relevant details are included. The identity of the applicant is revealed

once an agreement on the financial terms is reached. The procedure is finalized after the identity is disclosed and the Tax Authority confirms that it possesses no prior information relating to the applicant.

It is noteworthy that Swiss banks are encouraging their clients to participate in the voluntary disclosure procedure and cooperate fully with the client's advisors.

IV. Conclusion

The changes in Israel are no different from those taking place in other jurisdictions. The global economy,

increased cooperation among governments and various other issues have resulted in the need for individuals to voluntarily disclose unreported assets and income.

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