



## THE ERA OF AEOI

INBAL FAIBISH WASSMER  
AND GEORGE ROSENBERG  
PROVIDE AN OVERVIEW OF  
THE NEW ERA OF VOLUNTARY  
DISCLOSURE IN ISRAEL

THE ISRAEL TAX Authority (ITA), like many other tax authorities worldwide in the last few years, has taken many steps to encourage its residents to come forth and regularise any non-disclosed income or assets and become ordinary, compliant taxpayers.

In previous years, the ITA published various successful programmes that were repeatedly amended and extended. Under the previous call for voluntary disclosure, which expired on 31 December 2016, the ITA dealt with more than 7,500 applications, and the estimated capital disclosed was approximately ILS30 billion. Recently, in December 2017, the ITA published a new two-year disclosure procedure, which will also allow anonymous applications until the end of 2018. The publication was followed by a detailed circular as to the application procedure and the eligibility requirements.

Within the time frame of the recent disclosure procedure, and also within the framework of the current disclosure, the ITA has included applications with regards to assets held by trusts and foundations worldwide. Within the extensive coverage of the voluntary disclosure procedure however, the treatment of trusts and foundations remained somewhat unknown, and this article will try to serve as short guidance.

### AEOI

As of 2019, Israel will join the automatic exchange of information (AEOI) initiative as a 'late adopter', and will send and receive information with respect to financial accounts held by Israeli residents worldwide, directly and indirectly, as of 1 January 2018. This will include information on assets held in trusts and

foundations that have Israeli-resident settlors and/or beneficiaries.

Some families, trustees, service providers and institutions worldwide may not even know that they have reporting or tax obligations in Israel; others may think it is too late to voluntarily approach the authorities. We will outline in what cases a structure is exposed to reporting or tax in Israel, and how one can reach an agreement and avoid criminal and civil charges.

### REPORTING OBLIGATIONS IN ISRAEL

Under the *Income Tax Ordinance (New Version), 5721-1961* (the Ordinance), failing to report and file a tax return is a criminal offence that may result in heavy fines and imprisonment; failure to pay taxes is a civil breach of law and, as such, results in fines, interest and currency linkage payments.

Generally, the Ordinance provides that one must file a tax return in Israel, and pay the tax due (if any) in the following cases:

1. Israeli-resident individuals must report their worldwide income annually; however, individuals who enjoy the status of new residents (and in some cases returning residents) are exempted from reporting and paying taxes on their non-Israeli-sourced income and assets.
2. Non-residents who hold Israeli assets or earn Israeli-sourced income (some exemptions may apply).
3. Trusts and foundations that are classified in Israel as 'resident trusts', or that hold Israeli assets or receive Israeli income.

The Ordinance provides an extensive set of rules as to the cases in which a trust or foundation is subject to taxation and reporting in Israel. The table on page 59 can be used as a general guideline.

In all of the cases outlined, it is the duty of the trustee, or the board of the

### ➔ KEY POINTS

#### WHAT IS THE ISSUE?

One last time before stepping into the age of automatic exchange of information (AEOI), we wish to provide some guidance as to how trustees and individuals may deal with their tax and reporting liabilities in Israel.

#### WHAT DOES IT MEAN FOR ME?

Advisors and service providers that deal either directly with Israeli families or with structures that have Israeli beneficiaries must be aware of their reporting and taxation liabilities and take advantage of the current disclosure framework. This will probably be their last chance to regularise their matters with the Israel Tax Authority before AEOI begins in 2019.

#### WHAT CAN I TAKE AWAY?

Advisors can review whether or not they have any specific tax or reporting exposure in Israel, and, if so, how to deal with it in order to avoid any criminal charges.

FOCUS ON  
ISRAEL  
TRUST DISCLOSURE

CRITERIA	CLASSIFICATION IN ISRAEL	TAXATION	DISCLOSURE APPLIES TO
<ul style="list-style-type: none"> <li>The settlor is an Israeli resident; or</li> <li>Israeli-resident beneficiary;<sup>1</sup> or</li> <li>deceased non-resident settlor in a trust with at least one Israeli-resident beneficiary</li> </ul>	<b>Israeli-resident trust</b>	Worldwide accrued income is subject to tax in Israel	All assets and income
<ul style="list-style-type: none"> <li>Non-resident settlor;</li> <li>Israeli beneficiary</li> </ul>	<b>Israeli-resident beneficiary trust</b>	Worldwide accrued income is subject to tax in Israel	All assets and income
Israeli-resident beneficiary trust (see above) where: <ul style="list-style-type: none"> <li>the settlor, or settlor's spouse, is still living; and</li> <li>the settlor beneficiaries are related</li> </ul>	<b>Relatives trust</b>	Trustee may choose between: <ul style="list-style-type: none"> <li>taxation of distributions to resident beneficiaries (30%); or</li> <li>accrued income attributed to resident beneficiaries (25%)</li> </ul>	All assets and income
Irrevocable trust where there is: <ul style="list-style-type: none"> <li>a resident settlor;</li> <li>non-resident beneficiaries</li> </ul>	<b>Foreign-resident beneficiary trust</b>	<ul style="list-style-type: none"> <li>In some cases, the creation would be taxable;</li> <li>Subsequently, only Israeli-sourced income is taxable</li> </ul>	<ul style="list-style-type: none"> <li>Creation;</li> <li>Israeli-sourced assets and income</li> </ul>
<ul style="list-style-type: none"> <li>Non-resident settlors only;</li> <li>non-resident beneficiaries;</li> <li>Israeli public purpose beneficiaries (in which case, no resident beneficiary in the past)</li> </ul>	<b>Foreign-resident trust</b>	Only Israeli-sourced income is taxable	Only Israeli-sourced assets and income
If the deceased testator was an Israeli resident	<b>Testamentary trust/trust by will</b>	If at least one resident beneficiary – taxed as an Israeli-resident trust	All assets and income
		If all beneficiaries are non-residents – taxed as a foreign-resident beneficiary trust	<ul style="list-style-type: none"> <li>Creation;</li> <li>Israeli-sourced assets and income</li> </ul>

foundation, to submit annual tax returns and pay the tax due. There is a possibility under certain conditions to assign irrevocably the reporting and taxation obligation from the trustee to an Israeli-resident beneficiary; however, such an assignment is not retroactive.

Additionally, Israeli-resident beneficiaries must also report to the ITA the distributions they receive, even if such distributions are not subject to taxes. As of the tax year 2016 and onwards, Israeli-resident beneficiaries of trusts or foundations with a total value above ILS500,000 who are older than 25 must file an annual report with the ITA with respect to their beneficial rights, even if such beneficiaries have received no distributions and have no other duty to file annual reports in Israel.

#### FAILING TO REPORT

Undeclared assets held directly by Israeli residents can be regularised by approaching the ITA and reaching an agreement related to a 'trust arrangement'. Such an agreement provides immunity from any criminal proceedings and allows the settling of tax liabilities with respect to the period in question in one procedure. The decision to reach a trust arrangement is made by a dedicated unit in the ITA that

deals with foreign trustees, and is relatively quick and efficient. Once an agreement is reached, the ITA opens a new tax file for the trustee to start reporting and pay taxes annually. Some complications may occur throughout the procedure if documentation is limited, or at a later stage when payment needs to be made and funds must be transferred from a foreign bank to an Israeli bank in order to pay the tax due.

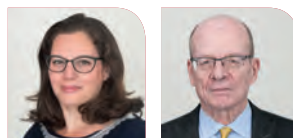
#### WHAT HAPPENS AFTER AEOI?

Or, in other words, is it urgent to act?

It is obviously advisable to approach the ITA with goodwill and to settle any possible liability before being approached by the ITA. First, review the possible tax exposure and then decide when to act, but also take into consideration that AEOI is not the only means by which tax authorities receive information; in fact, the ITA exchanges and receives information based on various treaty requests, and spontaneous and on-demand exchange of information.

Of course, AEOI will provide a massive amount of data to the ITA that could facilitate additional investigations. The regulatory framework for AEOI is not yet in place, although it is expected to be completed sooner rather than later. At any rate, it is better to act now. When dealing with structures that include Israeli residents, hold Israeli assets or receive income in Israel, it is imperative to check their liabilities and subsequently settle any possible past infringement by reaching an agreement with the ITA. When one is well advised and represented, the results may turn out much cheaper, and unpleasantness that may be involved in direct negotiations with the ITA, or inquiries and/or investigation by it, will be avoided.

<sup>1</sup> For the purpose of classifying a trust, the term 'Israeli-resident beneficiary' does not include 'public purpose beneficiary', as this term is defined in the Ordinance. In general, 'public purpose beneficiary' is used for charitable and/or not-for-profit institutions. In order to encourage distributions to such institutions, the Ordinance rules that having them as the only Israeli-resident beneficiaries does not change the classification of a trust as non-resident



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