U.S.-Israeli Tax and Estate Planning for Dual Citizens
Reconciling U.S. and Israeli Law on Trust Taxation, Inheritance Laws, Situs Wills, and Wealth Transfers

THURSDAY, SEPTEMBER 13, 2018
1pm Eastern  |  12pm Central  |  11am Mountain  |  10am Pacific

Today’s faculty features:

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Estate Planning & Probate for the Global Family Involving the U.S. & Israel

Osher Felicia M. Seaton, Esq.
Gidon Broide, CPA
No Longer Solely Domestic Planning

- Local estate planning attorneys must seek help.
  - Learning curve – cross border issues
- Pourover Will + Living Trust structure has pitfalls in Israel
- One Will? Two Wills?
  - Potential probate pitfalls
  - Be ready for investment outside of the U.S. & Israel.
Challenge of Cross Border Estates

- Extremely important to avoid probate in the U.S. with cross border estate
  - Cost – Court fee, Income Taxation
  - Numerous professionals
  - Lengthy process
  - Bureaucratic
- Israeli Will – Executor
- U.S. Income tax compliant? FBARs?

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Team Required

- US CPA
- Israeli CPA
- US Estate Planning Attorney
- Israeli Attorney

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Education Required

✓ U.S. citizens residing in Israel unaware U.S. tax applies.
✓ Educate regarding U.S. Federal estate & gift taxation & “mixed marriages”
✓ IRS Minimum Required Distributions at age 70.5
Incompetency

- One Power of Attorney for each country.
- No cross-border PoAs.

Community Property

- Israel is a community property jurisdiction.
- Consider impact on client’s estate plan & assess risk if there is a separation or divorce.

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Minor Children

✓ Minor children treated differently – U.S. & Israel
✓ Israeli Wills holding estate for U.S. minors – foreign non-grantor trust?
✓ U.S. trusts for minor beneficiaries
Planning for Minor Children

- If minors reside in Israel – name preferred guardian in Israeli Will
- 529 plans and Coverdells can be used to pay for tuition at some Israeli Universities.
- Keep and fund UTMA/UGMA accounts. Hard to find in Israel.

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US Estate Tax Solutions

✓ U.S. ILIT is possible for Israeli residents
✓ Charitable giving is limited among Israeli residents

Capital Gains Tax Issues
✓ Step up in basis U.S. vs. Israel

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Gift Tax Issues

- Buying child a home
- Child residing rent-free
- Unaware of gift tax and annual exclusion

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Miscellaneous Issues Arising

- Interesting whether foreign estates are subject to US Federal income taxation.
- Should US citizens apply for citizenship for their children?
10Y “Tax Holiday” Overview

• 10 year “tax holiday” is available to new immigrants and to returning residents who lived at least 10 years outside of Israel.

• Any income from assets held prior to immigrating to Israel is tax exempt and not reportable.

• There are planning opportunities during the 10-year period
  • Freedom to create, change, cancel
  • Serious planning before the end of the 10-year period
Plan In Advance – Israeli Tax Considerations

• US Business/Companies Income – Possible 10Y tax exemption
  • Should not require actual work in Israel other than general/management
  • Actual/significant business activity in the US, with full-scale US infrastructure.
  • Consider separate agreements/entities when working in both US & Israel

• US payroll – Full/partial exemption during 10Y “tax holiday”
  • When actual work is performed outside of Israel
  • Consider separate agreements/entities when working in both US & Israel
## Israeli Taxes For Certain US Entities

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<th>Additional Information</th>
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<td></td>
<td>Dividends taxed at 25% / 30%</td>
<td></td>
</tr>
<tr>
<td>LLC</td>
<td>Same as C Corp. UNLESS You ELECT to be taxed as transparent (pass-through) entity, in this case individual tax rates will apply [this option is available when management &amp; control are in the US]</td>
<td>ITA Circulas 5/2004 and 3/2002 Recent ruling – using LLC losses to reduce taxable income from other LLC’s is no longer an option</td>
</tr>
<tr>
<td>S Corporation</td>
<td>Similar to LLC’s</td>
<td></td>
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</tbody>
</table>
Plan In Advance – Trusts

• There are planning opportunities during the 10-year period
  • Freedom to create, change, cancel
  • The exemption is relevant to IBT's, which are exempt from paying tax and reporting trust income during the 10-year exemption period.
• IBT’s created during the 10-year period will also enjoy the exemption.
• Serious planning before the end of the 10-year period
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Israeli Income Tax Treatment of Foreign Trusts

Debra T. Hirsch, Esq.
Gidon Broide, CPA
Income Tax Treatment of Foreign Trusts

- **Israeli Income Tax Treatment of Foreign Trusts**
  - **Prior law**
    - Until 2014, Israel generally exempted from its income tax any trust that had been created by a foreign (such as U.S.) person, even if there were Israeli resident beneficiaries.
    - Similarly, Israel did not attempt to tax the Israeli resident beneficiaries on any trust distributions.
    - Israeli resident beneficiaries did not have to report a cash distribution received from a foreign-settled trust. Although not taxable, the advice was to report the income as tax exempt.
Income Tax Treatment of Foreign Trusts (Cont’d)

- 2014 Law imposing income tax on trusts with all foreign settlors and with Israeli beneficiaries.
  - Under the law that became effective 8/1/2013, many of these previously tax-exempt trusts and/or their Israeli resident beneficiaries have become subject to significant Israeli income tax liabilities and reporting obligations beginning with the tax year starting 1/1/2014.
  - Trustees have a number of reporting obligations, as well as tax filing deadlines.
  - Tax is imposed only on the portion of trust income attributable to Israeli residents.
Income Tax Treatment of Foreign Trusts (Cont’d)

• As practical matter, in most cases, U.S. trusts that report and pay taxes in the U.S. will likely have little or no additional Israeli tax liability, but still need to file.
• The law was intended to tax all trusts with an Israeli beneficiary.
Income Tax Treatment of Foreign Trusts (Cont’d)

- **Relative vs. Non-Relative Trusts**
  - Under the 2014 law, an Israeli Beneficiary Trust (IBT) is a trust under which all settlors are foreign residents, and there is at least one Israeli resident beneficiary.
  - An Israeli Beneficiary Trust (IBT) can be either a Relatives Trust or a Non-Relatives Trust. Being a Relatives Trust permits two choices of timing and rate of taxation.
  - See flowchart on slide at end of outline.
Income Tax Treatment of Foreign Trusts (Cont’d)

• To determine if you have an Israeli Beneficiary Trust, you need to know if there is an Israeli beneficiary currently.

• A beneficiary who is not entitled to distributions until after the death of a prior beneficiary (or the death of the grantor) is not considered a beneficiary until after the death occurs.
  ○ For example, U.S. husband establishes a trust under his will for his U.S. wife for her lifetime, after which his children (some of whom reside in Israel) are the remainder beneficiaries.
Income Tax Treatment of Foreign Trusts (Cont’d)

• The children are not considered “beneficiaries” while their mother is alive.
• Therefore, the trust is not required to register or report until 60 days after the mother’s death.
• No Israeli tax is imposed on the trust income during the mother’s lifetime.
• This allows some planning options while the mother is alive.
Income Tax Treatment of Foreign Trusts (Cont’d)

- **A Relatives Trust** must have two characteristics:
  
  1. Settlor is still alive [note for this purpose, if the Settlor’s spouse survives the Settlor, and was married to the Settlor at the time the Settlor made contributions to the trust, then the trust may maintain its Relative Trust status for the remaining lifetime of the spouse]. Once there is no more living foreign Settlor [or spouse], the trust becomes a regular IBT. The ITA is considering by-laws to exclude the share of foreign beneficiaries, but they have not yet been issued. In practice, the advice is to take a reasonable approach as to appropriate allocation to foreign beneficiaries. The taxable portion for the Israeli beneficiary must be listed on the registration of the trust, and changes must be reported.
  
  2. Settlor is closely related to Israeli resident beneficiary.
Income Tax Treatment of Foreign Trusts (Cont’d)

• **A Non-Relatives Trust** is subject to Israeli income tax (at regular rates of 25% for passive investment income and marginal rates from 15%-52% on other income) on world-wide income, on the portion allocable to the Israeli resident beneficiary.
Income Tax Treatment of Foreign Trusts (Cont’d)

- A Relatives Trust may elect to be taxed in one of 2 ways:
  - **Annual Tax Regime**: An annual tax at the rate of 25% is imposed on the trust level on the portion of the income allocated to Israeli resident beneficiaries. Subsequent trust distributions are not taxed to the beneficiary. In most cases, the annual tax regime makes sense, particularly for trust expected to make any distributions within the next 15-20 years.
Income Tax Treatment of Foreign Trusts (Cont’d)

• **Deferred Tax Regime**: No annual tax is imposed on the trusts. However, the Israeli resident beneficiary is taxed at the rate of 30% upon distribution of trust income. The law presumes that distributions come first from income (except original capital contribution to trust).
  • The law does not specify how to determine the allocation between Israeli and non-Israeli beneficiaries.
Income Tax Treatment of Foreign Trusts (Cont’d)

• Usually the ITA will accept a reasonable allocation as long as the allocation is in fact followed in making distributions (for example, if the trust has five beneficiaries, one of whom is Israeli, income can be deemed 20% taxable; but if more distributions are made to the non-Israeli beneficiaries, maybe a smaller percentage will be taxable by Israel).
Income Tax Treatment of Foreign Trusts (Cont’d)

- **2016 Israeli Tax Authority Circular Guidance**
  - In August 2016, the Israel Tax Authority (“ITA”) issued a circular with some guidance on the application of this law.
  - The guidance confirmed that any U.S. tax paid on trust income will be applied as a tax credit against Israeli tax, regardless of whether the tax was paid by the Settlor, the trust, or the beneficiary.
Income Tax Treatment of Foreign Trusts (Cont’d)

• This is especially important for U.S. grantor trusts, where the grantor pays the U.S. income tax on trust income.

• Matching U.S. tax payments to trust income for purposes of the credit will be much easier under the Annual Regime than under the Deferred Regime, because both countries will be imposing their tax on a current basis in the same year.

• For most trusts paying U.S. tax, there will be little, if any, Israeli tax to be paid on the trust income; however, the reporting requirements still apply.
Income Tax Treatment of Foreign Trusts (Cont’d)

- A recent amendment to the 2014 law requires Israeli beneficiaries starting from age 25 to file annual income tax returns if the assets of the trust are valued at NIS 500,000 or more (assuming they are aware that they are beneficiaries), even in years that no distributions were made.
- It is unclear what happens if the trust assets decrease in value below NIS 500,000, due to market fluctuations or exchange rates, after the beneficiary has previously reported. In practice, since file already exists, reporting recommended.
- Filing Requirements
Income Tax Treatment of Foreign Trusts (Cont’d)

- **Notification of Trust Existence:**
  - New Trusts: within 60 days of creation.
- **Israeli Resident Beneficiary:**
  - After beneficiary reaches age 25.
  - Any Israeli resident beneficiary who receives a distribution.
- **Choice of Annual or Deferred Tax Regime.**
- **Income Tax Returns.**
- **Forms.**
Income Tax Treatment of Foreign Trusts (Cont’d)

• Negotiated Arrangements with ITA
  • Past [pre-2014] tax liabilities.
  • May be option for step-up on asset basis.
  • May initiate discussions on an anonymous basis.

• Planning Recommendations
  • Separate trusts for Israeli resident and non-resident beneficiaries will avoid issue of how much of trust income should be apportioned to Israeli beneficiaries.
  • In practice sub-accounts in investment or bank accounts can achieve the same result.
• Open Issues.
• Enforcement of law against foreign trustees
  • Will any (civil or criminal) penalties be asserted against a trustee who does not comply with filing/payment requirements?
  • How will this be enforced against foreign trustees? Severe penalties/tax rates for Israeli beneficiaries.
10-Year Tax Holiday

- 10-year tax holiday is available to new Israeli residents (“olim chadashim”) and to returning residents who lived at least 10 years outside of Israel.
- Any income from assets held prior to immigrating to Israel is tax exempt and not reportable.
- The exemption is relevant to IBT's, which are exempt from paying tax and reporting trust income during the 10-year exemption period.
- In many cases registration of the trust during the 10-year period is recommended, even though the trust is exempt from taxes and reporting.
- Sometimes there are planning opportunities during the 10-year period.
- Any beneficiary is also not required to report his status during the 10-year holiday.
TAXATION OF TRUSTS UNDER NEW ISRAELI LAW

**Israeli Beneficiary Trust**
- All settlors are foreign resident, and
- There is a at least one Israeli resident beneficiary in the tax year.

**Relatives Trust**
- Settlor is parent, grandparent, spouse, child, or grandchild of beneficiary.
  [Note: If settlor and beneficiary are relatives of a second degree, they will be considered “relatives” for these purposes only if the assessing officer is convinced that the trust was settled at good faith and that the beneficiary has not used his right on the trust assets.]

**Non-Relatives Trust**
- All other trusts with foreign settlor and Israeli beneficiary.

**TAX**
- Subject to Israeli Taxes on worldwide income, taxable as Israeli Resident Trust according to identity of beneficiaries.

**Trustee**
- Must notify Israel tax assessor of trust status within 60 days of the creation of a new trust, or by end of January 2014 (within 180 days of the 9/1/2013 effective date of the new law for existing trusts).

**TAX WHEN SETTLOR IS LIVING**
- **2 CHOICES:**
  1. **Deferred Tax Regime** – Yearly trust income not taxed in Israel. Israeli resident beneficiary taxed at 30% rate upon distribution, except to extent distribution is proven to be principal (default assumption for these purposes is that income is distributed first).
  2. **Annual Regime** – Trustee may elect (irrevocably) that the trust be taxed at a rate of 25% on an annual basis with respect to the portion of the income allocated to Israeli beneficiaries. Distributions to Israeli beneficiaries would then be exempt from Israeli tax.

**TAX UPON DEATH OF SETTLOR**
- Subject to Israeli Taxes on worldwide income, taxable as Israeli Resident Trust according to identity of beneficiaries.
  [Note: The trustee has the option for taxation to continue as a Relatives Trust as if the settlor was still alive, if the surviving spouse is still living and was married to the deceased settlor at the time the settlor made any contribution to the trust.]
# Registration of Trusts in Israel – Forms and Required Information

<table>
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<tr>
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<th>Purpose</th>
<th>Relevant for *, **</th>
<th>Documentation</th>
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<td>152</td>
<td>Registration form</td>
<td>All IBT’s</td>
<td>Trust agreement, death certificate of Grantor (if applicable), copy of Trustee’s passport, Trust company certificate of incorporation and registration number, copy of Grantor’s passport, copy of Beneficiaries’ Israeli ID</td>
</tr>
<tr>
<td>147</td>
<td>Registration form</td>
<td>All IBT’s</td>
<td></td>
</tr>
<tr>
<td>151</td>
<td>Annual Trust information</td>
<td>All IBT’s</td>
<td>List of Trust assets at book value, list of distributions to beneficiaries</td>
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<tr>
<td>141</td>
<td>Notice of Irrevocable trust</td>
<td>Irrevocable trusts</td>
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<td>143</td>
<td>Notice: Foreign Beneficiary Trust</td>
<td>FBT’s – Israeli grantor</td>
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<tr>
<td>144</td>
<td>Election of Grantor/Beneficiary as tax representative</td>
<td>Some IBT’s</td>
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<tr>
<td>148</td>
<td>Notice: Choice of allocation of taxable income to Grantor or to Beneficiary</td>
<td>Some IBT’s</td>
<td>Trustee must still register trust, but in some cases, can choose to have Grantor or Beneficiary pay tax</td>
</tr>
<tr>
<td>153</td>
<td>Notice of Underlying Holding Co.</td>
<td>IBT’s with Underlying Co.</td>
<td>For each company: certificate of incorporation</td>
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<td>154</td>
<td>Relatives trust: Election of tax route</td>
<td>Relatives Trust</td>
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*IBT – Israeli Beneficiary Trust  **FBT – Foreign Beneficiary Trust
# Reporting Trust Taxes in Israel

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<tr>
<th>Form</th>
<th>Purpose</th>
<th>Signed by</th>
<th>Information</th>
</tr>
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<tbody>
<tr>
<td>1327</td>
<td>Annual Trust tax return</td>
<td>Israeli CPA</td>
<td>For Trust – <strong>1041</strong> or equivalent schedule. K1’s if applicable. 1040’s - If any trust income is taxable on 1040’s of the Grantor and/or Beneficiaries, to claim a tax credit for taxes paid in the US.</td>
</tr>
<tr>
<td>1324</td>
<td>Schedule D – Foreign Income and foreign tax credits</td>
<td>Israeli CPA</td>
<td></td>
</tr>
<tr>
<td>151</td>
<td>Annual Trust information</td>
<td>US Trustees</td>
<td>Annual list of additions to trust assets. Annual list of distributions to beneficiaries (all principal and income distributions, not just income distributions).</td>
</tr>
</tbody>
</table>
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U.S.-Israeli Tax and Estate Planning for Dual Citizens

K. Eli Akhavan, Esq.
Agenda

- U.S.-Israel Income Tax Treaty
- U.S. Disclosure Requirements
U.S. – Worldwide Taxation

• U.S. imposes tax based on two theories:
  • Residence of taxpayer
  • Source of income

• Individuals are “residents” for income tax purposes:
  • Citizenship
  • Lawful permanent resident (greencard)
  • Substantial presence (with certain exceptions)
U.S. Income Taxation (cont’d)

- U.S. persons have:
  - Taxation on worldwide income
  - Reporting and filing requirements
U.S. Estate Taxation

- Israel does not have an estate tax and this is not addressed in the US-Israel tax treaty.
- A US citizen living in Israel is subject to US estate taxes. Due to FATCA, this has become an increasingly relevant issue.
U.S.-Israel Income Tax Treaty

- Income tax treaties in general seek to avoid double-taxation when two jurisdictions have tax authority. For example, a US citizen who is a citizen and resident of Israel can potentially be subject to both US and Israel taxation.
- The treaty exempts US social security payments received by residents of Israel.
- US federal, state and local governmental pensions are taxed only in the United States.
- Non-government pensions are taxed in Israel, even if earned while working in the United States.
- Capital gains earned on US securities are taxed in Israel.
Savings Clause and Capital Gains

- Article 15 of the Treaty provides that the “resident of one of the Contract States shall be exempt from tax by the other Contracting State on gains from the sale, exchange or other disposition of capital assets.”

- Article 6, Paragraph 3 of the Treaty provides that notwithstanding any other provision of the Treaty (except for Paragraph 4), a Contracting State may tax its residents/citizens as if Treaty doesn’t exist (with some exceptions).
Cole v. Commissioner

- Elazar Cole, a citizen of the United States moved to Israel in 2009 and became a permanent resident there in 2010.
- In April of 2001 he had purchased 3,000 shares of stock for approximately $42,000, and sold all of them between September and November of 2010 for approximately $157,000, while he was a permanent resident of Israel.
- Cole filed a U.S. income tax return reporting the gain, but did not include it as taxable income because of Article 15 of the Treaty.
Cole (cont’d)

• IRS mailed a notice of deficiency in January 2014 for the taxes due ($13,000 plus accuracy-related penalty of $2600)

• Cole filed a petition disputing the determination arguing that he was exempt because of Article 15. The IRS took the position that Article 6, the Savings Clause, controlled.

• Tax court held for the IRS and rejected Cole’s argument that the Savings Clause nullified the whole treaty.

• Expatriation should be evaluated under certain circumstances
Treaty Disclosure

- A treaty based return position must be disclosed per Internal Revenue Code Section 6114.
- A dual-resident taxpayer discloses a treaty based position on IRS Form 8833.
- Some exceptions apply.
U.S. Reporting and Disclosure Requirements

- U.S. citizens and greencard holders must file annual tax returns even if all income is earned outside the United States.
- Most US-Israeli citizens living in Israel won’t owe US taxes because of taxes paid to Israel.
- Foreign Earned Income Exclusion under Section 911 of the Code allows a US taxpayer who is a resident of another country to exclude from gross income, income earned from services performed in another country. For 2018, this amount is $103,900.
Hirsch v. Commissioner

- Michael Hirsch was a dual US-Israel citizen. Some years after moving to Israel, he became employed by Merrill Lynch as an investment adviser. He split his time between Israel and the US, and spent 2/3 of his time in Israel.

- Pursuant to Section 911 of the Code, a qualified individual may exclude “foreign earned income” from income earned from services performed within Israel. Two requirements must be met:
  - Individual must have a tax home in a foreign country.
  - Individual must be a bona fide resident of a foreign country for an uninterrupted period which includes an entire taxable year.

- Tax home is not same as personal residence. Court found that Mr. Hirsch’s place of business was in New York because of his employment relationship with Merrill Lynch, including restrictions on where he could conduct business, and the fact that he was not authorized to work out of the Merrill Lynch office in Israel.
Information Exchange Agreement

• Israel and the United States have entered into an Intergovernmental Agreement (“IGA”) under which Israel’s financial institutions submit FATCA (Foreign Account Tax Compliance Act) reporting information to the Israel Tax Authority, which will automatically exchange the information with the U.S. Treasury.

• Essentially, banks in the United States and banks in Israel must report each other’s residents’ bank accounts.
US Disclosure Requirements

• US citizens who are also residents/citizens of Israel must report their foreign financial accounts and assets if they meet the requisite thresholds.

• Owning or having signature authority over a foreign financial account that has more than $10,000 will require filing FinCen Form 114.

• IRS Form 8938 – Statement of Specified Foreign Financial Assets should be filed by US citizens living in Israel as follows:
  • Single taxpayers who own foreign financial assets that are worth $200,000 on the last day of the year, or $300,000 at any time during the year
  • Married filing jointly taxpayers who have foreign assets of $400,000 on the last day of the year, or $600,000 at anytime during the year.
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U.S.-Israel Tax Treaty
Mechanism and Implementation in Israel

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Basic Treaty Mechanism

- **US Citizens** (and some Green Card holders) living in Israel are generally obligated to file both Israeli and US tax returns.
- They are subject to taxes on their worldwide income.
- Israeli residents may claim a foreign tax credit on their US return for taxes paid in Israel (certain limitations apply).
- Israeli residents may claim a foreign tax credit in Israel for taxes paid in the US (certain limitations apply).
- The end result should be a tax liability equal to the highest tax rate (Israel/US) for each type of income, and generally no double taxation of income.
Basic Treaty Mechanism

• Tax rates applicable for each Country.
• Who (Israel/US) taxes the income first – right to “first bite”.
• Utilizing deductions.
• Utilizing foreign tax credit.
• Planning to avoid partial double taxation.
### The Numbers – Comparing Tax Rates (2017)

<table>
<thead>
<tr>
<th>Income</th>
<th>United States (excludes Medicare tax)</th>
<th>Israel</th>
<th>Israel + Wealth Tax****</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ordinary Income</td>
<td>39.6%**</td>
<td>47%**</td>
<td>50%**</td>
</tr>
<tr>
<td>Dividends</td>
<td>Regular 39.6%**</td>
<td>25% [30%*]</td>
<td>28% [33%*]</td>
</tr>
<tr>
<td></td>
<td>Qualified 20%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Interest</td>
<td>39.6%**</td>
<td>25% [30%*]</td>
<td>28% [33%*]</td>
</tr>
<tr>
<td></td>
<td>0% Municipal Bonds***</td>
<td>15% [unlinked instruments]</td>
<td>18% [unlinked instruments]</td>
</tr>
<tr>
<td>Capital Gains</td>
<td>Short Term 39.6%**</td>
<td>25% [30%*]</td>
<td>28% [33%*]</td>
</tr>
<tr>
<td></td>
<td>Long Term 20%</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

** Top marginal tax rate  
*** Usually exempt  
* Controlling Shareholder  
**** 3% On annual taxable income above NIS460,000
## Israeli Taxes on US Income

<table>
<thead>
<tr>
<th>Income Type</th>
<th>Israeli Taxes</th>
<th>Comments</th>
</tr>
</thead>
<tbody>
<tr>
<td>US Pension</td>
<td>Reduced rate per Sec. 9(c)</td>
<td>Taxed at the same rate it would have been taxed in the US had it been the taxpayers only source of income</td>
</tr>
<tr>
<td>Social Security Benefits</td>
<td>Exempt</td>
<td></td>
</tr>
<tr>
<td>US Rental income</td>
<td>30% - 47%</td>
<td>0% - 47% for taxpayers aged 60 or older</td>
</tr>
</tbody>
</table>
The Right to First Bite (Article 26(2) of Treaty)

- Real Estate Rental Income – Location of the property
- Dividends, Interest, Royalties – Where earned
- Capital Gains – Country of residence
- Capital Gains from sale of real estate – Location of the property
- Business Income – Country of residence unless work performed in the other country in which the taxpayer has a permanent establishment or even where no permanent establishment.
- Salary/Employment income – Where earned, unless the taxpayer spends 183 days or more in the other country during the tax year (Section 16)
• Israel Tax Authority will generally allow actual expenses and unlike the IRS will not cap them.
• The US standard deduction can’t be used as a deduction for Israeli tax purposes.
• When using the standard deduction in the US, ask your professional to provide a Schedule A of itemized deductions (may be used on your Israeli return).
• Charitable contributions are used as tax credit (35%) and not as deductions.
• Some US deductions are not allowed – e.g. medical, home mortgage interest.
Foreign Tax Credits

- Israel will allow - in most cases - a $ to $ tax credit for US taxes paid on income taxed by the US in accordance with the Treaty. Tax credit will be limited to the tax rate applicable in Israel.
- Foreign tax credits, not utilized during the current year can be carried forward for five years.
- For foreign tax credit purposes, US taxes should be allocated to the various types of income – specific allocation or average are generally accepted.
- US State taxes may be used as a foreign tax credit.
- The ITA will not permit a tax credit for Medicare tax.
There is NO Social Security Treaty

- Israel has no Social Security treaty with the U.S.
- Payments to Social Security are usually not deductible.
- Other U.S. income such as real-estate income may be subject to both Social security and Israeli National Insurance (unless taxed at 15% route).
- Self Employment Tax (15%) is not deductible and may not be applied as a foreign tax credit – This requires tax planning to avoid double taxation.
Israeli Tax Filing - Other Considerations

• U.S. Charitable Contributions – subject to certain limitations, can be reported – will generate a 35% tax credit. Does not apply to Trusts and Foundations.
• State taxes can be used as a foreign tax credit.
• Don’t forget to consider social security/national insurance.
• Make sure your Israeli CPA/tax advisor as well as your US tax professional are aware of the specific issues related to Israel-US taxes.
Costly mistakes

• Not applying the first bite rules properly:
  ➢ Example:
    ➢ Capital gains from sale of shares by an Israeli resident, were reported for many years on her US 1040 and significant taxes were paid in the US.
    ➢ The ITA audited her Israeli tax return and demanded that the US capital gains be taxed in Israel at 25%.
    ➢ The IRS refused to amend some of the years, resulting effectively in double taxation.

• Ignoring the 10-year “tax holiday”
• Forgetting when the 10-year “tax holiday” is about to end
This presentation provides general guidelines and does not provide tax advice. Before making decisions consult with a tax professional for specific tax advice.

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