As U.S. cracks down, many Israelis finding themselves liable for taxes

Those with U.S. citizenship or a Green Card have to file, even if they never stepped foot in America. Violators risk having their bank account blocked

Efrat Neuman

American citizenship is coveted by many Israelis, but R., a young woman from Givatayim, discovered that it can also be a major headache.

As a child, she received U.S. citizenship through her father, but she never lived in the United States. She has a checking account at Bank Hapoalim and recently went to the bank to open a joint account with her husband.

"When they asked me if I held any other citizenship, I naively told them, 'Yes, I have American citizenship,'" she recalls. "Then the bank said it needed my social security and U.S. passport numbers. I tried to tell them I was never issued a Social Security number, but there was no one to talk to."

A few days later, R. went to another Hapoalim branch to pick up checkbooks she'd ordered for her existing account. Another unpleasant surprise awaited her: The computer now showed that since she was a U.S. citizen who hadn't submitted the required information, her account had been blocked.

To obtain a Social Security number, she would have to go to the U.S. Consulate in Jerusalem. She had to wait two weeks for an appointment, at which she was told she would be issued a number in four to six months. Meanwhile, the bank wouldn't let her touch her account.

This case illustrates the impact of the U.S. Foreign Account Tax Compliance Act – FATCA – that Israel agreed several years ago to enforce with the United States. Among other things, it requires banks and financial institutions outside the United States to report the accounts and assets of their American customers.

Since the Knesset this summer passed legislation implementing FATCA in Israel, the Israel Tax Authority has begun passing on to the U.S. Internal Revenue Service details of the bank accounts held in Israel by U.S. citizens and Green Card holders. Banks are now obliged to inform their customers of the new requirements.

Monte Silver is an attorney at the Herzliya law firm Eitan, Mehulal & Sadot who specializes in tax and cross-border matters between Israel and the United States. He says the duty to report bank details applies to anyone with more than $10,000 in accounts outside the United States.

In practice, anyone with less than $50,000 in an Israeli bank account won't arouse much interest on the part of the IRS. But someone with more than that who has failed to file annual reports to the IRS may incur a hefty fine of 27.5% on the largest balance held over the past six years. In certain cases, the penalty can be even higher.

U.S. citizens are obligated to report on their bank accounts and income outside the United States even if they're not U.S. residents. So anyone with U.S. citizenship or a Green Card – hundreds of thousands of people in Israel – is required to report all bank accounts outside the United States and file a tax return to the IRS every year.

Reporting foreign bank accounts to the United States was voluntary until it emerged that tens of thousands of Americans were keeping unreported funds in the Swiss bank UBS. FATCA was the result.

Careful with that U.S. real estate

Implementation of FATCA has been underway for several years, so people who want to stay under the IRS' radar have had time to take steps to avoid its reporting requirements. But some Israeli banks have instructed foreign residents with accounts below $50,000 to close them to avoid falling into an "unreported zone" that could get the banks in trouble with Washington.

People who haven't yet reported their Israeli bank accounts can do so with the IRS' Streamlined Filing Compliance Procedures. They will have to file retroactive reports on their income for the past three years (and pay any required taxes), provide bank balances for the last six years and sign a declaration of good faith.

People found to have deliberately concealed income may be fined based on the largest accumulated value in their accounts in recent years. If they are not found to have been trying to cheat

Monte Silver *Eyal Toueg*

the IRS, they will pay no fine and receive immunity from any criminal proceeding.

In the past decade, many Israelis have invested in real estate in the United States after prices crashed following the 2008 financial crisis. Super-low interest rates are pushing investors to seek investments abroad that will bring better returns, and cheap credit has created attractive financing conditions.

But many Israelis aren't aware that by purchasing property in the United States they are liable for U.S. inheritance tax. If you accumulated assets in the United States of more than $60,000, after your death your estate could face taxes of 10% to 40% for each dollar over $60,000 – even you weren't an American citizen and never visited the United States.

U.S. securities of companies incorporated in the United States also fall under this category. Many Israelis invest in stocks of U.S. companies as a way to diversify their portfolios, but it's the people who aren't investing in the millions of dollars and therefore haven't gone to great lengths to avoid tax exposure who should be the most attentive to the American rules.

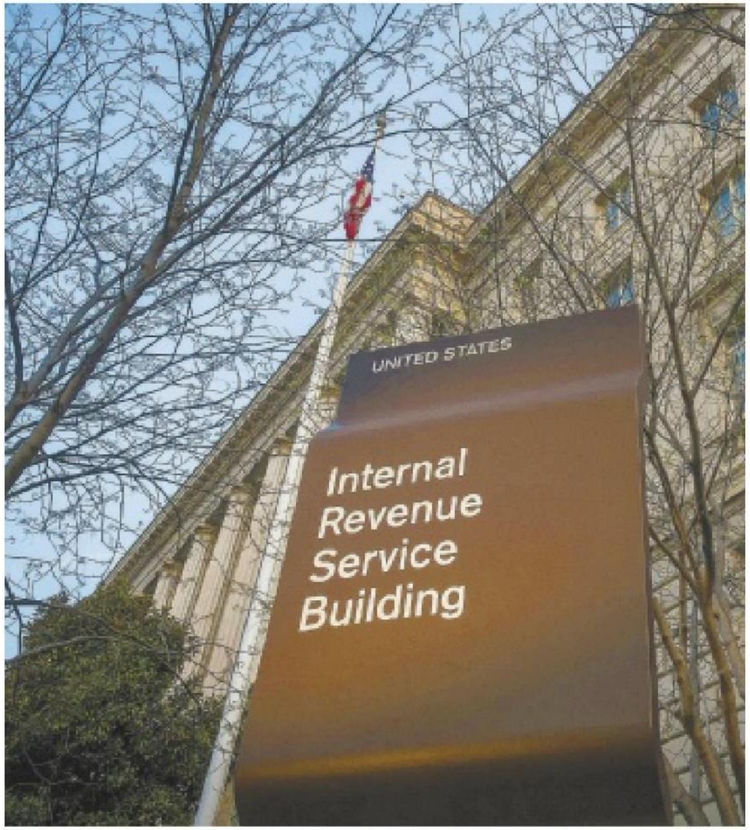
The taxation rules become more complicated for people who do not live in the United States, who have a lot of money around the world and are U.S. citizens or holders of a Green Card. Even if a Green Card has expired and the holder had made no effort to renew it, he or she is required to file a tax return. For tax purposes, a Green Card remains relevant forever unless the holder cancels it.

U.S. assets worth more than $60,000 are in any case subject to inheritance tax, but a Green Card holder who is not a U.S. citizen and whose domicile is not in the United States will not be required to pay inheritance tax on assets outside the United States.

U.S. citizens, even if they do not live in the United States, must contend with various inheritance tax rules for assets outside the United States.

The $5.4 million question

The heirs of a U.S. citizen will be required to pay up to a 40% tax on an inheritance larger than $5.4 million, even if the heirs are not Americans – because U.S. tax applies to whoever bequeaths the inheritance. By the same token, if the person who bequeaths assets outside the United States is not a U.S. citizen, but the heirs are U.S. citizens, the inheritance tax doesn't apply.



IRS headquarters in Washington: Not just internal revenue anymore. *J. David Ake / AP*

The $5.4 million threshold applies to an individual, not a couple. So if both members of a couple are American citizens, with proper planning they can enjoy a $10.8 million exemption.

The tax applies to gifts as well, so this same U.S. citizen cannot transfer the assets to his children in his lifetime to avoid the inheritance tax. If he wishes to give up his citizenship, he will have to pay a hefty emigration/departure tax, unless complex tax planning is done.

Someone with assets under $2 million (and therefore not subject to the departure tax) who wishes to give up his U.S. citizenship and passport must pay $2,400 for the process and file tax returns for the last five years if he hasn't done so already.

Silver, a U.S. citizen who immigrated six years ago and does not plan to renounce his U.S. citizenship, says that for older Americans who have retired, aliyah can pay off financially. He cites his parents as an example – they now live in Israel and receive a monthly Social Security payment of thousands of dollars.

People 67 and older who worked in the United States for at least 10 years are eligible for Social Security benefits. Health insurance in Israel is also much cheaper than in the United States, where it can cost thousands of dollars per month. "Because of the high cost, many seniors in the U.S. live without health insurance," Silver says.

If an American immigrant has assets exceeding $5.4 million, it may be worth it for him to give up his U.S. citizenship to be exempt from the inheritance tax. But tor assets in the United States to be exempt from the tax, they must be sold prior to the person's death.