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Professionals' Contribution to the Legislative Process: Between Self, Client, and the Public

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How may professionals be made to contribute to legislative processes so that their expertise redounds to the public interest, despite the legislative product being likely to have a negative impact on their clients' wealth? Drawing on a case study of the legislative process that gave birth to Israel's recent (2002–2008) trusts taxation regime, based on five years of participant observation among the trust professional community, I find that to obtain the benefit of private-sector professionals' expertise under such circumstances, government should have legislation drafted in a dispassionate, exclusive environment of experts rather than in the political arena; it should build professionals' trust in government by adopting an explicitly collegial approach; it should focus reform efforts on elements of the existing law so clearly inequitable as to make a refusal to contribute difficult to justify; and take care that the new regime creates a compliance practice lucrative enough to compensate for any loss to professionals consequent on its enactment. Once professionals' interests are suitably safeguarded, their loyalty to clients appears surprisingly brittle and government can successfully combine with them in the public interest.

INTRODUCTION

Professionals, such as lawyers, accountants, and bankers, often contribute expertise to legislative processes. Their motivations in contributing tend to correlate with the subject matter of the legislative effort. The literature documenting professionals' contributions to legislative efforts shows that when addressing issues destined to influence the wealth of either themselves or their clients, professionals usually promote the interests of either or both of those groups (Halliday 1987; Macey and Miller 1987; Picciotto 1992; Goforth 1995; Maurer 1995; 1997; Carruthers and Halliday 1998; Karpik 1999; Abel 2003; Dukeminier and Krier 2003; Sitkoff and Schanzenbach 2005; Rostain 2006; Sikka 2008; Halliday and Carruthers 2009).

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This article responds to Halliday, Carruthers, and Liu's call for sociolegal studies of legislative processes (Halliday and Carruthers 2007, 1142; Halliday and Liu 2009, 913) by proposing a set of conditions under which professionals may contribute to legislative processes so that their expertise redounds to the public interest, despite the legislative product being likely to have a negative impact on their clients' wealth. I develop that set of conditions out of a case study of the legislative process that gave birth to Israel's recent (2002–2008) tax regime governing private noncharitable irrevocable trusts. The Israeli Tax Authority (ITA), lacking personnel with the necessary expertise for crafting a trusts taxation regime, made intensive use of professionals—two lawyers and an accountant—throughout the legislative process. The resulting tax regime redounded to the public interest, defined, for the purposes of this article, as the equitable distribution of the tax burden between higher and lower income, more and less sophisticated taxpayers. It did so by transforming the use of trusts with Israeli settlors, trustees, or beneficiaries from at least partly an exercise in tax avoidance into a regulated practice, subject to tax at the same rates as other unincorporated means for asset management and investment. Simultaneously, it preserved the income Israeli trust professionals earned in creating and maintaining trusts by constructing a tax regime so complex as to require the purchase of costly professional compliance services, while crafting that regime so as partly to remedy Israeli trust professionals' earlier competitive disadvantage vis-à-vis foreign trust professionals. The article thus provides a striking case study, of generalizable value, of professionals' roles in constructing and negotiating the legal arrangements that they then operate (for which role, see Halliday 1987; Picciotto 1992; Dezalay 1995; McCahery and Picciotto 1995; Carruthers and Halliday 1998). It shows elite professionals strategically cooperating with the state in transforming a field of professional action, previously lucrative as a means for avoiding state burdens, into an arena of compliance so demanding as to retain, from the professional perspective, its lucrative nature. Because clients are unorganized, relying on professionals to promote their interests vis-à-vis the state, the latter proved able to undermine the interests of powerful high net worth individuals (HNWIs) by purchasing the cooperation of their fiduciaries. The article demonstrates the essential independence of professionals' interests from those of both their clients and the public served by the state with which those clients contend. It also shows under what conditions professionals' interests may nevertheless be dovetailed with those of the public.

Based on five years of participant observation among Israel's trust professional community, on oral histories of Israeli trust practice, and on a rich range of complementary sources, the article advances the law and society literature on *demand creation and norm entrepreneurship by professionals*. Abel's emphasis (1988a, 44–48; 1988b, 212–18; 1988c; 1989, 83; 1991; 2003, 484–88; cf. Shamir 1995, 10) on the production of demand for legal services through state legal aid programs and legal clinics has been complemented by scholarship on norm entrepreneurship, lawyers' manipulation of the legal rules and structures they use so as to bolster demand for their services (McBarnet 1984; 1992; 1994; Powell 1993; Dezalay 1995). More generally, Brint (1990; 1994) studied the conditions conducive to experts' influence on policy making (see also Carruthers and Halliday 1998, 74). A growing literature documents lawyers' *self-interested contributions to legislative processes*, sculpting statutory norms calculated to increase demand for legal services: see, for example, Offer (1981) (English land law and taxation); Macey and Miller (1987) (Delaware corporate law); Picciotto (1992) (international tax law); Waters (1995, 313) (Bermuda trust law); Goforth (1995) (US LLC law); Carruthers and Halliday (1998) (US and UK bankruptcy law); Sitkoff and Schanzenbach (2005) (the abolition of the rule against perpetuities in many US states); Rostain (2006) (US tax law); Friedman (2007, 125–39) (abolition of the rule against perpetuities); and Ganado (2011) (Maltese trust law). Karpik's (1999, 257–93) study of a legislative process concerned with redefining the provinces of the several French legal professions marks an extreme of professional domination of legislative processes, the state having limited itself to ratifying a new order of the professionals' own making; compare Abel's description of the adversarial birth of English legislation of the 1990s intended to break the legal professions' monopolistic practices, initiated by the government over the strong objections of many legal professionals (2003, 33–95, 293–353).

A rather thinner literature specifically addresses *tax professionals' involvement in statutory tax reform* (Picciotto 1992; Rostain 2006) and the conditions under which such involvement may promote the public interest. The International Monetary Fund (IMF), in the *Tax Law Design and Drafting* manual it directed at developing countries engaged in reforming their tax infrastructure, warned against the "dangers in involving members of the private sector too deeply in the formulation of tax legislation" (Gordon and Thuronyi 2000, 9), recommending the "better practice . . . [of] not . . . mak[ing] representatives of the private sector privy to tax proposals until they are publicly announced" (9). It appears, however, that government consultation with tax professionals during the formulation of "tax proposals" is quite common in some of the world's most developed countries. Her Majesty's Revenue & Customs (UK) "regularly consults tax professionals before enacting legislation" (Alt, Preston, and Sibieta 2010, 1270), while during the far-reaching New Zealand tax reforms of the 1980s, "senior tax professionals played crucial and constructive roles on consultative committees . . . receiving public submissions, commenting on government proposals and making policy suggestions" (White 2009, 133). Such data affirm Stephen Brint's suggestion, based on US data, that "the situation that is most congenial for professional power is at the time of the discovery of problems . . . and the inauguration of regulatory proposals" (1990, 376). Since, despite the IMF's broad warning, tax professionals are often in practice deeply involved in crafting statutory tax reforms, elucidation of the conditions necessary in order for their involvement to promote the public interest is clearly important.

Few attempts at such elucidation have so far been made. Hoffmann (1981–1982) drew some relevant lessons from his comparison of two instances, c. 1980, of the American Bar Association tax section's involvement in congressional tax reform efforts. In one case, the section's position was clearly pro-client, while in another, contemporaneous case the section managed a public-interested view. Hoffmann found that the tax bar is likelier to take the latter type of view if discussion takes place between bar and government tax experts alone, without nonexperts taking part. He noted that a reform effort targeted solely at combating avoidance casts bar members as their clients' protectors, while a more balanced initiative, which includes pro-taxpayer elements, particularly on a subject that the bar agrees needs reform, makes an even-handed approach on the part of the bar more likely; much more so if the bar agrees on the general direction reform should take, and if the Treasury is willing to revise its views where it overreached. Hoffmann further found that a collegial approach on the part of the revenue authorities, manifested by including the bar in the legislative process, can itself make the bar cooperative, out of a wish that the authorities maintain their collegial approach in the future (Hoffmann 1981–1982, 520–22). This article confirms many of Hoffmann's findings, while highlighting an option he omitted—disengaging professionals' own interest from that of their clients. I show that where such disengagement is possible, tax professionals can contribute, in the public interest, even to legislative processes that are largely focused on combating tax avoidance and thus likely to harm the interests of at least some of their clients. One example of such a contribution was exposed in Rostain's study of the US tax bar's involvement, early last decade, in governmental efforts at combating corporate tax shelter abuse (Rostain 2006). The present study provides another such example, as well as a contribution toward the theorization of the subject.

The article is structured as follows. After reviewing the research methods employed, I briefly discuss Israel's lack, until recently, of a tax regime applicable to private irrevocable trusts. This is followed by a description of the process by which, between 2002 and 2008, an Israeli tax regime applicable to private irrevocable trusts has, at length, been put into place. I analyze the ITA's success in obtaining the benefit of professionals' expertise in drafting its trusts taxation regime, despite the major purpose of the new regime having been eliminating a tax opportunity from which those professionals' clients have drawn great benefits. Having identified the causes of the ITA's success, I extrapolate the structural conditions that may permit other professional contributions to legislative processes to conduce to the public interest despite the legislative product's negative impact on client wealth. The conclusion underlines the unique contribution of my study to the norm entrepreneurship literature, explains the interprofessional cooperation evident in the case under discussion, and suggests avenues for further research.

Research Method

There is now a considerable amount of sociolegal research on corporate lawyers (Slovak 1979; Chayes and Chayes 1985; Nelson 1988; Galanter and Palay 1991; Powell 1993; Heinz and Laumann 1994; Liu 2006; Galanter and Henderson 2008; Coates et al. 2011), but sociolegal research on "private client" lawyers—the lawyers who provide the wealthy with their succession and tax minimization plans—is rare (a key exception is the series of articles by McBarnet focusing on norm avoidance and "creative compliance": e.g., 1984, 1992, 1994, 2003). Such lawyers often engage in activities of which many are likely to disapprove, such as creating "asset protection trusts" to disappoint divorcees, malpractice and other tort plaintiffs, tax authorities, and other creditors (Hirsch 2005–2006). Consequently, they adhere to an ethos of confidentiality. Obtaining high-quality information on their practice requires a long acculturation process; it requires, essentially, that the researcher blend into the professional group.

I obtained data for my analysis of the 2002–2008 legislative process that gave birth to Israel's new trusts taxation regime by employing two principal qualitative research methods: long-term participant observation and interviews (some additional sources are discussed below). My participant observation consisted in having, from 2006 to 2011, spent many days in the company of several of Israel's foremost trust professionals, joining them as lecturer, student, audience member, and academic cotraveler for conferences, intensive continuing legal education courses (one semester in 2006, followed by a four-semester-long diploma course in 2008–2010), routine professional meetings, and lengthy conversations. To deepen my participation in the practices of this professional group, in 2007 I became a member of the Israel Bar's trusts committee and in that capacity was exposed to parts of the complex and stormy enactment process described below. In 2008, I joined Israel's trust professionals as a member of STEP Israel—the local branch of the (worldwide) Society of Trusts and Estates Practitioners, their pre-eminent professional organization (for STEP worldwide, see Harrington 2012). Since then, I have continued to attend STEP conferences and other trusts-taxation-focused events targeted at a professional audience, attempting to spend as much time as possible in the company of Israel's leading trusts professionals and absorb their subject, their practices, their milieu, and their perspectives.

My participant observation resulted in a fund of data concerning Israeli trust professionals' current practice. The data address characteristics of their client pool; which circumstances lead to the use of what trust structures; preferred jurisdictions for trust creation; the size and characteristics of the Israeli trust professional community, its knowledge base, and social capital; some trust professionals' roles in organizations (law firms, trust companies, banks, accountancy firms, corporations, investment companies, charities, wealth management firms, family offices) and others' functioning as solo lawyers, accountants, trustees, wealth managers, or tax advisors; what they see as the problems currently besetting their field; their view of the future potential of the field; and further data concerning client management, trust creation, and trust management, as well as adjacent legal, tax, and accounting issues.

Having overlapped in time with the later stages of the 2002–2008 enactment process, my participant observation also resulted in a fund of data concerning that process, as discussed and debated in personal conversations, conferences, CLE classes, and committee meetings. These data provided most of the materials for my thick description of the enactment process. They also included different practitioners' views, at different points in time throughout the research period, regarding the new regime, its implications for trust practice, professionals' role in its formation, and their always-fraught relationship with the ITA.

Research by participant observation (Spradley 1980) has advantages and disadvantages. Its principal advantage is that by functioning as group insiders for a long period of time, researchers may obtain data unobtainable using other research methods, such as surveys (e.g., Coates et al. 2011) or controlled experiments (e.g., Cooper and Wenzel 2009), particularly when researching social and practical contexts characterized by a high degree of confidentiality, such as trust practice. One of the disadvantages of participant observation is that the data obtained are more difficult to evaluate and confirm than data obtained by survey or experiment. Further, data obtained by participation in the examined practice can be strongly context and time specific (if less time specific than data obtained by survey or experiment, due to the typically longer research timeframe); they may also suffer from unknown lacunae. To compensate for the last disadvantage, I conducted eleven formal interviews, lasting from half an hour to several hours each. Three more interviews were conducted by a student. Ten of the fourteen interviews were conducted in person. Though fairly unstructured in nature, the interviews were focused on the uses Israeli professionals and their clients make of the trust form, on the formation of the recent trusts taxation regime, and on practitioners' relationships with the ITA. I sought to corroborate or refute the data obtained in each interview through questions posed in later interviews. Nine of the subjects were leading Israeli trust professionals, selected according to knowledge I have obtained by participant observation. One subject (Alon Kaplan) was interviewed three times. Of the nine professionals, two (Meir Minervi and Shlomo Kerem) are retired, while the rest are currently practicing. To gain perspective on the trust professionals' narratives, I also interviewed three key public servants who took part in the 2002–2008 legislative process (Frida Israeli, Moshe Asher, and Yaron Shidlo) and a lawyer who uses trusts in a family-law-focused practice (Dov Frimer). The interviews are all listed, by subject name and date, in the references section; I refer to them by their subjects' names.

The tax regime in question having become effective on December 31, 2009, I applied on September 22, 2011 to the ITA, asking for information on the results of its application. I posed questions regarding the volume of trust filings with the ITA, the amounts actually raised by application of the new regime, and the estimated costs of the exemptions the regime contains. Following repeated prodding, including several dozen phone calls, I received, on January 1, 2012, data concerning the volume of trust filings. My other questions were left unanswered, citing the costs of retrieving additional data. Additional data concerning trust filings were obtained in an interview held August 1, 2012.

I complemented the data obtained through participant observation and interviews with data obtained by documentary analysis. The documentary sources used included case law, court applications, transcripts of parliamentary committee and plenum sessions, professional literature (including materials produced by STEP), commission reports, and newspaper stories, all of which are listed in the references section.

TAXING IRREVOCABLE PRIVATE TRUSTS: THE OLD ISRAELI TAX GAP

Since before Israeli independence and until quite recently, residents of Palestine and, later, Israel were subject to both a heavy tax burden (Morag 1967, 73–76, 79; Yoran 1990, 740–41; Yitzhaki 2005; Nissim 2005; Suary and Paserman 2005, 260–62) and a heavy burden of regulatory restrictions on transactions involving foreign parties, as well as on Israelis' holding foreign currency locally and holding assets of any type abroad (Barkai 2004, 81–82; Michaely 2004). Israelis holding of assets, capital and income, abroad required, until the late 1990s, a permit from the foreign currency control department at the Bank of Israel. While exchange and currency control were gradually lifted during the 1990s, the marginal income tax rate imposed on high-income individuals started declining only in the mid-2000s, and heavy indirect taxation is still in place. Given that Israeli residents did not generally, until 2003, owe income tax on income earned abroad, many Israelis found generating income abroad and keeping property abroad attractive. They were able to accumulate untaxed assets abroad due to the often cursory enforcement of both nonwage taxation and the currency control regime. Permits allowing the holding of assets abroad were given (Schachat), and many not given them chose to hold assets abroad in defiance of the currency control regime (Kaplan). Another obvious omission in the tax system was the absence of a tax regime applicable to irrevocable private trust income and gains.

The 1941 Income Tax Ordinance of Mandate Palestine (hereinafter: ITO, still currently in force in Israel in an official Hebrew-language version of 1961) has since 1945 included three antiavoidance provisions that empower the tax authorities to disregard certain transactions. One provides that income received by unmarried persons aged twenty or less as a result of a disposition by another shall for income tax purposes be seen as accruing to the disponor, defining "disposition" to include "trust" (ITO 1947, the final Mandate-era version, §24). Another provides that income received by one as a result of a revocable disposition by another shall for income tax purposes be seen as accruing to the disponor, again defining "disposition" to include "trust" and defining "revocable" broadly to include any case where the disponor, his wife, or her husband retain a direct or indirect power to reassume direct or indirect control over the income or the assets yielding it (§25). A final provision imposes what is now known as a General Anti-Avoidance Rule: it provides that the assessing officer may disregard any disposition, trusts included, which reduces the amount of tax payable and that is, in his or her opinion, artificial or fictitious or that "is not in fact given effect to" (§28; see Likhovski 2004, 345, 367–77; 2007, 670–82; Alter 1985, 207–49; Leibovich 2008, 273–368).

Having empowered the tax authorities to disregard trusts for unmarried beneficiaries aged twenty or less and trusts the settlors of which retain a power to reassume control over assets purportedly transferred on trust and/or the income they yield, the ITO had until 2005 included almost no provisions governing the taxation of irrevocable private trusts, the settlors of which have lost all control over trust property, generally (a few provisions governed the technicalities of taxing trusts for incompetents and nonresidents: ITO 1947, §§34–36, 38, 41). Many questions were thus left unanswered: Where (irrevocable) trust property yielded income, who was assessable in respect of that income—settlor, trustee, or beneficiary? Who had to file a return in respect of trust income? Nor was the taxation of capital gains on trust assets referred to in the 1949 Act to Impose a Tax on the Appreciation of Land, which first imposed a capital gains tax in Israel, or in the 1965 amendment of the ITO, which extended the incidence of that tax to personal property. Some progress was made in the 1963 successor to the 1949 Act, which provided that no tax shall be payable on trustees' transfer of rights in land in Israel to their beneficiaries (Act to Impose a Tax on the Appreciation of Land 1963, §69; see discussion of the pre-2005 positive law of trusts taxation, such as it was, in Yoran 1980; Alter 1985, 192–262). The absence of a tax regime generally applicable to irrevocable trusts could be read to imply that income and capital gains earned on irrevocable trust assets were not subject to tax.[1]

1. Trusts where the settlor or its relatives maintain some form of control over the trust assets or the trustees are usually less useful than irrevocable trusts for minimizing a family's tax burden (Rawlings 2011, 291–94).

The tax authorities also suffered from a grave information deficit concerning trusts. With settlors explaining that they no longer owned the trust assets, beneficiaries claiming they did not own them yet, and trustees usually abroad and out of reach, the authorities could do little to obtain information on trusts some or all of the parties to which were Israeli. Without information, the general antiavoidance rule in the ITO was of little use, while the antiavoidance provision tailored for revocable trusts was rendered impotent by most Israeli-related trusts describing themselves as both discretionary and irrevocable. While ITA personnel realized that many trusts that were discretionary and irrevocable on their face may have functioned quite otherwise in practice, they had no means of obtaining information on the practical working of such trusts (Asher). This reality constituted trusts as an easily exploited route to tax burden minimization. It was not until 2002 that the ITA set its sights on blocking that route.

A NEW DEAL WITH THE PROFESSIONALS: ISRAEL'S TRUSTS TAXATION LEGISLATION OF 2002–2008

The major beneficiaries of Israel's long-lived trusts taxation gap were local and foreign HNWIs, as well as a part of the professional class—the lawyers, accountants, and other professionals servicing trusts. As the ITA, during the first decade of the twenty-first century, has slowly formulated a tax regime governing irrevocable trusts, it adopted an intriguing approach to the trenchant compliance problem characteristic of taxation generally and trusts taxation specifically (for analysis of the tax compliance problem generally, see, e.g., Anderoni, Erard, and Feinstein 1998; Braithwaite 2003). It cut a deal with an elite part of the professional class, formulating a trusts taxation regime so as to preserve professionals' income from trusts practice while transforming that practice from a form of tax avoidance to a tax-compliant exercise. The nearly decade-long legislative process described below demonstrates one practical means for curtailing avoidance: once the professionals involved were included in the governmental process of formulating a regime for taxing irrevocable trusts, and their interests served by that regime encouraging the retention of their services, they cooperated in eliminating a notorious tax opportunity from which many clients drew significant economic advantages.

Much of the literature on the "tax legislative process" focuses on private parties and legislators contracting for tax reform legislation beneficial to the former, such as legislation creating new "tax expenditures" (see, e.g., Doernberg and McChesney 1986; Birnbaum and Murray 1988; Roin 1988; Shaviro 1990; Zelinsky 1992). The enactment process of the Israeli regime for taxing irrevocable trusts followed a different pattern. It closed a major gap in the law. Long exploited by a relative few, the gap became more notorious, and was more often exploited, as Israeli currency control was lifted in the late 1990s and Israeli income tax was in 2003 first imposed on income Israeli residents earned abroad. A 2000 tax reform committee report that threatened the imposition of an estate tax also contributed to the popularization of trust use. As an obvious case of avoidance, escaping tax by using irrevocable trusts was seen as indefensible, and was not seriously defended by anyone: the then-chairman of the Knesset Finance Committee, Ya'acov Litzman, commented, as the committee was debating the new trusts taxation regime in the summer of 2005, that trusts taxation was the easiest part of the taxation bill of that year to pass, given the broad agreement on the issue (Proceedings of the Finance Committee, the Knesset, July 20, 2005, 2). The new regime inflicted serious losses on trust users, many of whom were now first exposed to Israeli tax on their trust activities. It also threatened the trust professionals who constructed earlier avoidance mechanisms with at least temporary revenue loss. Such professionals could render their loss temporary by refocusing their activities on supplying (demanding, and thus costly) compliance services instead of avoidance services. As we shall see, elite trust professionals chose to strike a long-term deal with the state, while other professionals, who could, perhaps, less easily afford the long-term view, complained bitterly about the curtailing of hitherto profitable activities (for a comparison of the long-term approach of the top end of the bar with the survival tactics of the rest of the bar, see Shamir's discussion of the US bar's reaction to the New Deal: Shamir 1995, 119).

2002–2005: Enactment

The enactment process started early in the last decade. Despite the Israeli tax authorities having long been aware of the trust's function as a tax avoidance mechanism, the trusts taxation problem was largely left to one side in the major wave of tax reform enacted in the summer of 2002, which first imposed Israeli income tax on income Israeli residents earned abroad. Though Davida Lachmann-Messer, the Ministry of Justice's veteran fiscal legislation specialist, noted, in discussing that summer's major tranche of tax reform legislation before the Knesset Finance Committee, that "the trick today is appointing a trustee somewhere . . . and registering the company there . . . the company holds shares in Israeli companies . . . and you pay no tax" (Proceedings of the Finance Committee, the Knesset, July 21, 2002, 42), the 2002 amendment included only a limited, preparatory basis for a future trusts taxation regime. It imposed reporting requirements, from which most Israeli individuals were then and are now exempt, on trust settlors and beneficiaries (ITO 1961, §§131(a)(5b), 131(c1); see discussion in Gross 2002, 237–38), with a view to preparing a database for future use, if and when an effective tax regime is imposed on irrevocable private trusts. The nonimposition of such tax left the trust tax opportunity intact and easily available, permitting the (arguably, legal) construction of one's property as outside the wealth mass subject to the burdens imposed by the state.

The Israeli authorities' delay in enacting a tax regime governing irrevocable private trusts can be partly explained by the difficulty of the task. As Israel does not impose any transfer taxes (estate, inheritance, or gift taxes), the challenge was restricted to taxing trust income and capital gains realized on transferring assets in and out of trust. Still, even this task confronts the tax legislator with several difficult questions. For one, to whom should income accrued on trust assets, while they are held in trust, be attributed? Tax avoidance having been a major purpose of the very development of the "use," predecessor of the trust, in late medieval England (Getzler 2002, 43), the trust presents the fiscal authorities with a difficult dilemma: trustees are usually the formal owners of both the trust assets and income accrued thereon, but they do not benefit from them (other than in drawing their fees). The trust's beneficiaries may be in principle entitled to benefit from income accrued on trust assets, but so long as that income or the assets producing it have not been distributed to them, their enjoyment is as yet merely potential. Its actualization is often made contingent on various conditions the fulfillment of which may be hard to predict; or it may be subjected to trustees' unfettered discretion. Another difficult issue is the appropriate rate for taxing trust income. While trust income that has been distributed to beneficiaries may be aggregated with their income from other sources and taxed at the appropriate rate, undistributed income presents more of a challenge. Should trusts enjoy the benefits of progressive taxation, permitting wealthy settlors to escape its burdens by settling many small trusts? Should trusts enjoy the deductions and exclusions permitted to individuals? Or should they be taxed as if they were artificial legal persons, such as corporations? The trust mechanism allows planners and their clients to dissolve the strong bond of property ownership, which both permits enjoyment and imposes a burden of social and legal obligations, including the obligation to pay tax.

The taxation of capital gains on trust property presents further problems, especially given a legislative commitment to taxing such gains only on realization (for the realization principle, see Malman et al. 2010, 120ff). Should a settlor's transfer of property into trust be seen as realization of that property? And what about the distribution of trust capital to beneficiaries? Should one or both of those two capital transfers be seen as a gift (often tax exempt in Israel)? Or, if they are taxable, who should pay capital gains tax on each occasion and at what rates? The attribution of capital losses creates further baffling questions. Lastly, the practice of residents settling nonresident trusts or enjoying the benefit of such trusts creates significant additional complication. When is a trust locally resident for tax purposes? Is it enough that a trust's settlor, or one of its several settlors, is a local resident? Is it enough that a trust has one locally resident beneficiary? If a trust managed out of the jurisdiction is viewed as locally taxable, how does the local tax authority go about receiving reports and collecting tax from foreign trustees?

Some light is thrown on the answers given to these questions by central English-speaking jurisdictions' trust taxation regimes, as they stood when the Israeli tax authorities started formulating their own such regime, by a 1990s IMF manual entitled *Tax Law Design and Drafting* (Easson and Thuronyi 2000). According to this manual, "a hybrid system is usually adopted [for trusts taxation], under which a beneficiary who receives trust income is taxed on that income, while income accumulated by the trustee, to which no beneficiary is currently entitled, is taxed in the hands of the trustee" (Easson and Thuronyi 2000, 950–51). "Problems with the use of trusts for tax avoidance can be minimized by specifying that all trust income that is not flowed through to beneficiaries should be taxed at a flat rate equal to the top marginal rate applicable to physical persons" (955). However, "[i]n practice, few of the countries that have well-elaborated rules for taxing trusts do impose tax at the top individual rate" (956). As to determining the residence of a trust for tax purposes, the manual comments that several factors may be taken into account, with the trustee's residence and the place the trust is managed or administered generally being the most important (961–62).

Some Israeli jurists started proposing schemes for the taxation of irrevocable trusts in the early 1980s (Yoran 1980; Alter 1985), but the decisive effort at correcting the legislative omission was at length made by a Trusts Taxation Commission appointed immediately after the tax reform legislation of the summer of 2002 was enacted. The commission, known informally as the “Israeli Commission” for its Chair, certified public accountant (CPA) Frida Israeli, then Vice-Commissioner of Income Tax, reported in July 2003. Its members, personally selected by Tali Yaron-Eldar, Commissioner of Income Tax, included both Treasury personnel and three of Israel’s premier trustees and tax planners by way of trust, lawyers Alon Kaplan and Meir Linzen and accountant Alex Hilman. The Israeli tax authorities thus defied what the IMF, in its 1990s manual, called the “dangers in involving members of the private sector too deeply in the formulation of tax legislation” (Gordon and Thuronyi 2000, 9), choosing not to follow the IMF’s “better practice . . . [of] not . . . mak[ing] representatives of the private sector privy to tax proposals until they are publicly announced” (9). It followed instead a “pattern of activity” Halliday noticed, “by which controversial, aging, or inadequate statutes are ‘withdrawn’ from the public realm, drastically revised in a private ‘depoliticized’ setting, and then reintroduced to public debate” (1987, 365). As shown below, the practitioner members’ contribution to the commission’s recommendations was both significant and distinct.

The commission innovated both by suggesting that all trust income be taxed at the top marginal rate applicable to individuals and by integrating the tax treatment of trusts involving a foreign element into that of irrevocable trusts generally. It sorted all irrevocable trusts into three major classes for tax purposes, classifying them according to the residence of their settlors and beneficiaries, but not that of their trustees or the underlying companies through which those trustees hold the trust assets. Income accrued on the assets of *Israeli residents’ trusts* was to be taxable at the top marginal rate applicable to individuals. While the transfer on trust of the assets of such trusts was seen as an instance of realization, the gains realized were to be tax exempt where had the assets been transferred directly, by way of gift, from settlor to beneficiary, an exemption from capital gains tax would have applied. Given that Israel exempts both gifts to donors’ relatives and other bona fide gifts (ITO 1961, §§97(a)(4)–(5)) and that distributions of trust income and capital to beneficiaries were not to be seen as instances of realization, an *Israeli residents’ trust* could run its course without gains accrued on trust assets being subject to tax (though when either the trustee or the beneficiary finally sold a trust asset, the gains realized since the settlor purchased that asset would be liable to tax). The income of a *foreign settlor trust* was to be seen as earned by a foreign resident; accordingly, only trust income derived from Israeli sources was to be subject to Israeli income tax. Capital gains accumulated in such trusts were largely exempt, following the same principles applicable to gains accumulated in *Israeli residents’ trusts*.[2] Trusts of foreign property settled by a foreign settlor for an Israeli beneficiary were thus to be fully tax exempt—a considerable concession by the Treasury now that income Israeli residents earned abroad was regularly subject to Israeli income tax. Lastly, the transfer of assets by an Israeli resident settlor on a *foreign beneficiary trust* was also to be seen as an instance of realization, and given that Israelis’ direct gifts to foreign donees are fully taxable, gains realized on such transfer were to be liable to capital gains tax. Once the

2. Where less than fifteen years had passed since one or more settlors of a *foreign settlor trust* were Israeli residents, distributions from such a trust would have been liable to tax at a rate of 15 percent (Trusts Taxation Commission 2003, 49–51).

assets were safely ensconced in trust, however, they were to be seen as held by a foreign entity and, hence, only income derived from Israeli sources would have been liable to Israeli income tax. Asset transfers between two foreign entities being normally exempt from Israeli tax, a similar exemption was to be extended to capital distributions from *foreign beneficiary trusts* (Trusts Taxation Commission 2003).

There was one precedent for the commission's unusual choice of settlor residence as key to trusts' liability to Israeli tax: New Zealand similarly exempts trusts settled by nonresidents from liability to New Zealand income tax on income sourced outside New Zealand (New Zealand Income Tax Act 2007, §HC 26). It was commission member Alon Kaplan who suggested, having consulted with Professor John Prebble, a key author of the New Zealand trusts taxation regime, that trusts be classified, for Israeli income tax purposes, according to settlor residence. It was the commission members hailing from the private sector who suggested that foreign-settled trusts be exempted from Israeli income tax on foreign-sourced income. Aware that the flow of private capital into Israel exceeded, as of 2002, $4 billion annually, they convinced their public-sector colleagues that trusts nonresident settlors funded for resident beneficiaries should be exempted, lest taxation stem that flow (Kaplan).

The Israeli Commission's report having been temporarily laid to one side, it slumbered for the best part of two years until adopted by another commission, appointed in early 2005 by Binyamin Netanyahu, the Minister of Finance, to devise a long-term tax reform plan. In its report of June 2005, the Multi-Annual Tax Plan Commission of that year made some changes to the detail of the Israeli Commission's recommendations. The principal modification made was that the distribution of trust assets to their beneficiaries, rather than those assets' earlier settling on trust, was now to be seen as an incident of realization, thus prompting liability to capital gains tax in case a direct gift of the assets from the settlor in question to the beneficiary in question would not have been exempt from that tax. The tripartite classification for tax purposes of all irrevocable trusts according to their settlors' and beneficiaries' residence was retained (Multi-Annual Tax Plan Commission 2005, 149–52).

The Israeli legislative machine now acted with remarkable speed. The recommendations of the Multi-Annual Tax Plan Commission, including those regarding trusts taxation, were made into a lengthy Bill Amending the Income Tax Ordinance and that Bill was quickly enacted by the Knesset between July 6 and 25, 2005, as Amendment no. 147 of that Ordinance. As the Bill included measures far more politically sensitive than trusts taxation, such as sharp cuts in both the marginal income tax and companies tax rates, which threatened a reduction in state revenue and thus a curtailment of the Israeli welfare state, discussion of the trusts taxation regime before the Knesset plenum was perfunctory. Although there was a more substantial discussion of the proposed regime in the Knesset Finance Committee, the objections some committee members raised were no match for the phalanx of well-informed ITA representatives, who dominated the crucial committee meetings on July 20 and 21. Committee members, politicians all, seem to have found the details of the convoluted regime difficult to grasp.

The effects of the amendment are summarized in Table 1.

The resulting trusts taxation regime is dramatically different from those of leading trust jurisdictions, such as the United States and United Kingdom, and fairly similar to that of New Zealand (see discussion of the new regime in Kaplan and Eyal 2006). In a

TABLE 1.
Rudiments of Israeli Trusts Taxation: Before and Since 2006

	Before January 1, 2006	After January 1, 2006
Imposition of tax on trust income	Income of revocable trusts, irrevocable trusts for unmarried beneficiaries aged 20 or less, artificial trusts, fictitious trusts, and trusts "not in fact given effect to" taxable as if accruing to the settlor; no provisions as to income of other trusts, so such income believed by many to be exempt, though ITA never admitted this	The pre-2006 provisions subsist; new regime applicable to irrevocable trusts generally; income of *Israeli residents' trusts* generally taxable; income of *foreign settlor trusts* and *foreign beneficiary trusts* exempt unless produced in Israel.
Imposition of tax on trust capital gains	No tax payable on trustees' transfer of rights in land in Israel to their beneficiaries; no other provisions, so trust capital gains believed by many to be fully exempt, though ITA never admitted this	Exemption of trustees' transfer of rights in land in Israel to their beneficiaries subsists; new provisions applicable to all other situations: *Israeli residents' trusts*: settlement of assets on trust does not trigger liability; asset distribution to beneficiaries triggers liability in case a direct gift of the assets from the settlor to the beneficiary would not have been exempt; *foreign settlor trusts*: exempt; *foreign beneficiary trusts*: settlement of assets on trust triggers liability; asset distribution to beneficiaries is exempt
Income tax rates imposed by source of income	Rates imposed on income caught by antiavoidance provisions: General rate, imposed on salaries, business income: between 10–50%, depending on settlor's income and frequent rate changes Dividends: generally 20% Rent, other than by way of business: 10%, and often exempt; if rent derived abroad, 15%; if a business, general rate applies Interest payments: 20% if linked to Consumer Price Index (CPI), 15% otherwise Lottery, prize, and gambling winnings: 25% Income from sale of copyright, patent, or design, other than by a professional author, inventor, or designer: general rate, capped at 40% Posthumous income: general rate, capped at 40%	General rate: 48%, top marginal rate applicable to individuals since 1.1.2012 Dividends: until 1.1.2012, generally 20%; thereafter, generally 25% Rent, other than by way of business: 10%, and often exempt; if rent derived abroad, 15%; if a business, general rate applies Interest payments: until 1.1.2012, 20% if linked to CPI, 15% otherwise; thereafter, 25% if linked to CPI, 15% otherwise Lottery, prize, and gambling winnings: 25% Income from sale of copyright, patent, or design, other than by a professional author, inventor, or designer: general rate, capped at 40% Posthumous income: general rate, capped at 40%
Capital gains tax rates imposed by asset type	Real property: where assessee an individual, general income tax rate, capped at 20%; where assessee a company, gains taxed at the companies tax rate, 34% in 2005 Personal property: where assessee an individual, generally 20%, or for financial assets, where not linked to CPI, 15%; where assessee a company, generally 25%	Real property: where assessee an individual, general income tax rate, capped at 20%; where assessee a company, gains taxed at the companies tax rate, 25% in 2012 Personal property: until 1.1.2012, where assessee an individual, generally 20%, or for financial assets, where not linked to CPI, 15%; where assessee a company, generally 25%; after 1.1.2012, rates 25%, 15%, 25%, respectively

All data are as of August 1, 2012.

Data Sources: Israeli Income Tax Ordinance, Real Property Taxation Act (Capital Gains and Purchase Tax), available at http://www.nevo.co.il (accessed November 5, 2012).

nutshell, Israel taxes trusts less aggressively than the United States and the United Kingdom and the employment of an Israeli professional as a trustee does not aggravate the trust's liability to Israeli tax, while the employment of a US or UK trustee does aggravate the trust's liability to US and UK tax, respectively. As regards the extent of tax imposed on trusts, Israeli trusts can, as mentioned above, in many cases complete their lifecycle without liability to capital gains tax arising at any point. Like New Zealand, Israel does not impose any inheritance, estate, or gift taxes. While Israel's top marginal income tax rate applicable to individuals is currently 48 percent (ITO 1961, §121), most trust income is passive income, subject to discounted rates of between 10 and 25 percent (ITO 1961, §§122–125F; see Table 1). These lower rates, along with the nonimposition of taxes other than the income tax, mean Israel imposes lighter taxes on trusts than do the United States and the United Kingdom. Even New Zealand imposes a heavier tax burden on trusts than does Israel: it imposes a uniform income tax rate of 33 percent and while, unlike in Israel, there is no capital gains tax properly so called, capital gains can be "income" for income tax purposes. Under current US tax law, the transfer of assets on trust creates liability to either gift or estate tax, according to the manner of the trust's creation (inter vivos or mortis causa, respectively). Capital distributions create liability to capital gains tax. Although most dividends are currently taxed at lower rates (usually 15 percent), rental and interest income are, unlike in Israel, subject to the top marginal rate of income tax imposed on individuals, currently 35 percent (Internal Revenue Code 1986, §1). This rate is applicable to trust income starting at an annual income of $11,350 (see discussion of current US income tax, as imposed on trust income, in Price and Donaldson 2011, §10.4). Under current UK law, the transfer of assets on trust renders its settlor liable to capital gains tax. If the trust assets extend beyond the "nil-rate band," that is, are worth more than £325,000, they are liable to inheritance tax as well, at rates of 20 percent for trusts created inter vivos and 40 percent for trusts created mortis causa. Trusts pay income tax on their retained income at a special, higher rate and do not enjoy the benefit of the deductions and credits applicable to individuals. Beneficiaries owe tax on income distributions they receive, grossed up to include the income tax their trustees paid, though they receive a credit equal to that tax. Distributions may also create liability to both capital gains tax and inheritance tax. UK law even creates liability to inheritance tax at points in time between settlement and distribution: many trusts owe a "periodic charge" to inheritance tax every ten years (for the UK taxation of trusts, see Moffat, Bean, and Probert 2009, 374–419).

The comparative data are summarized in Table 2.

Beyond the extent of tax imposed, Israel's new trusts taxation regime bears the imprint of several policies. The *first* is a preference for the domestic accumulation of funds: the regime attempts to encourage foreign settlors' creation of trusts for Israeli beneficiaries by offering such *foreign settlor trusts* an almost complete exemption from Israeli tax, while Israeli settlors' creation of trusts for foreign beneficiaries is discouraged by imposing, unusually, capital gains tax on their creation.

A *second* clear object of the new regime is encouraging the use of Israeli, rather than foreign, trust professionals. When the regime was before the Knesset's Finance Committee, Treasury personnel were declaring the prevention of trust clients preferring foreign over Israeli professionals to be a key goal of the new regime (see

TABLE 2.
US, UK, New Zealand, and Israeli Trusts Taxation Compared

	US	UK	New Zealand	Israel
Tax rate imposed on undistributed trust income	10%–35%	10%–50%	33%	10%–48%
Tax rate applicable to trust capital gains	0%–15%*	28%	No such tax, but gains can be income for income tax purposes	10%–30%
When is capital gains tax due?	On capital distributions	On asset transfer into a trust; on capital distributions; when a beneficiary becomes absolutely entitled to one or more assets; other circumstances	Never	Not normally due on trust creation or distribution; due when trust asset sold
Inheritance/estate tax rate applicable to trusts	35% subject to $5,000,000 exemption	40%, subject to an £325,000 exemption	No such tax	No such tax
When is inheritance/ estate tax due?	When an asset is bequeathed to a trust	On asset transfer into a trust; at every tenth anniversary of an asset's being held on trust (at a much lower rate); when an asset is transferred out of trust (at a rate of up to 6%); and on the death of all settlors and some beneficiaries	Never	Never
Gift tax rate applicable to trusts	35%	20%, subject to an £325,000 exemption; the tax is called inheritance tax even when the transfer is inter vivos	No such tax	No such tax
When is gift tax due?	When an asset is gifted to a trust, other than by will	Same as inheritance tax	Never	Never

*These rates applicable to capital gains on assets held for more than a year; otherwise the income tax rate applies.

All data are as of August 1, 2012.

Data Sources: US: Price and Donaldson 2011, §10.4; UK: Her Majesty's Revenue and Customs webpage, http://www.hmrc.gov.uk (data are for tax year 2012–2013); NZ: Department of Immigration webpage, http://www.dol.govt.nz/immigration/knowledgebase/item/3307 (data updated July 11, 2012); Israel: Israeli Income Tax Ordinance, available at http://www.nevo.co.il (all three websites accessed November 5, 2012).

proceedings of the Finance Committee, the Knesset, July 20, 2005, 5 (Jacky Matza) and 8 (Davida Lachman-Messer)). This policy is most clearly evident in three aspects of the new regime. *One* is the determination of trusts' residence for tax purposes according to their settlors' and beneficiaries' residence, while their trustees' residence and the place each trust is administered—the two factors most influential, according to the IMF *Tax Law Design and Drafting* manual, in determining a trust's residence under key "onshore" tax systems—are, under the new Israeli trusts tax regime, as under that of New Zealand, irrelevant to that determination (ITO 1961, §75P(c)). Unlike under current US and UK law, the employment of a local trustee does not in Israel render a trust more likely to be subject to local tax. A *second* feature of the new regime facilitative of the employment of local trustees concerns the incorporation of an Israeli underlying company to hold the trust assets, shares in that company being held by the trustee. Such a structure is an accepted way for carrying out trustees' duty of keeping the assets of each trust they administer separate from their personal assets and from the assets of other trusts. Israeli trustees' holding trust assets by way of such a company does not create liability to Israeli companies tax, despite the company being controlled and administered in Israel, a situation that usually gives rise to liability to such tax (§75P(b)). The new regime renders such underlying companies "tax transparent": their income is seen for tax purposes as if it accrued to the trustee, their assets as if held by it (§75C, definitions of "trustee" and "trustee assets"). The "tax transparency" of underlying companies was specifically suggested by the private-sector members of the Israeli Commission (Israeli and Linzen). Lastly, a *third* feature of the new regime that clearly encourages the gainful employment of trust professionals, even if it was not designed with that end in mind, is the regime's extreme complexity. As Ronen Shamir noted, paraphrasing Andrew Abbott, "simple problems and obvious solutions are not conducive to the monopolization of expertise and lead to the deprofessionalization of practice" (Shamir 1995, 117; see also Weisbach 1999, 885; Ribstein 2004, 347). The description provided above is no more than a general outline of the new provisions, which define the different classes of trust for tax purposes, as well as such fundamental concepts as "settlor" and "beneficiary," in complex, unexpected ways, including various alternative scenarios and formulations in each definition. The parsing, for purposes of practice, of the resulting legislative text requires great professional acumen and serving the large variety of required notices and reports on the tax authorities would take many billable hours.

It is clear, then, that the Israeli Commission has taken care to formulate the new trust taxation regime so as to preserve the rich pickings of trust practice despite the transformation of that practice from an existence largely unregulated by Israeli law—a form of tax avoidance—to a heavily regulated, compliant practice. The commission's choice to encourage the use of Israeli, rather than foreign, trust professionals emanated from its public-sector members, who believed that a market trend away from foreign and toward Israeli resident trustees would make enforcing the new regime more practicable than otherwise (Asher and Shidlo). The results of the commission's work explain the optimism Kaplan and Linzen expressed regarding the consequences of the new regime for Israeli professionals' trust practice (Kaplan and Linzen). The two were not, however, the sum of their profession, as was made clear in the events that followed enactment of the new regime.

2005–2010: Recursivity

The events following enactment demonstrate Halliday and Carruthers's theory of the recursivity of law (Carruthers and Halliday 1998, 53–57; Halliday and Carruthers 2007, 2009; see also Halliday and Liu 2009). Professionals' reactions to the regime drove a series of adjustments, some enacted as statutory amendments, some as regulations, and some as ITA administrative directives. The regime thus underwent a full recursive cycle—from enactment, to a critical response by the professionals tasked with implementation, to amendment—before it was ever put into practice; professionals only finally started reporting in December 2009 (Hilman).

Many Israeli trusts practitioners greeted the enactment of Israel's trusts taxation regime with dismay. One, Akiva Laxer, went so far as to challenge the new regime before the High Court of Justice. Laxer argued that the regime's long-arm provisions requiring foreign resident settlors, trustees, and beneficiaries to report and pay tax to the ITA were unconstitutional, unreasonable, and contrary to the applicable conflicts rules. He argued that Israeli and foreign banks, insurers, investment managers, and others serving as trustees for numerous beneficiaries could not possibly comply with the new regime's onerous requirements. He further argued that the regime was hastily enacted, did not receive appropriate parliamentary consideration, would deter foreign residents from visiting Israel, and might bring some Israelis to emigrate (High Court of Justice Application 11522/05 *Laxer v. Minister of Finance*).

Amendment no. 147 having come into force on January 1, 2006, the 2006 tax year was the first to which the new regime applied. While in nontrust contexts, Israeli assessees were to file annual reports for 2006 by April 2007, complying with the provisions of the new trusts taxation regime by that date was impossible: existing report forms had yet to be adjusted to its intricacies. Nor was the ITA yet prepared to process the stream of reports and notices for which the new regime called. Laxer's court application seems to have been partly intended to apply pressure on the ITA so that it would make the requisite forms available. Applying similar pressure was also a key purpose of a Trusts Committee set up in early 2007 by the Tel-Aviv District Council of the Israel Bar. The committee vowed to "initiate and accompany trusts legislation" (Protocol of Meeting held February 25, 2007; for bar committees' involvement in legislative processes, see Hoffmann 1981–1982; Rostain 2006). In January 2007, the Tel-Aviv District Council itself applied to be joined in Laxer's application as amicus curiae (*Laxer v. Minister of Finance* January 16, 2007).

Having myself participated in some meetings of the Bar Trusts Committee, I experienced committee members' deeply skeptical approach to the new regime. The meetings I attended occasioned a profusion of complaints, describing the new regime as impossible to implement and likely to destroy, rather than reform and invigorate, Israeli professionals' trusts practice. Some of the points Laxer and the bar committee members raised clearly required attention. According to the new regime, the presence of one Israeli resident beneficiary—even among a large number of foreign beneficiaries—rendered an otherwise *foreign beneficiaries' trust* into an *Israeli residents' trust*, so that its trustees had to pay Israeli income tax on all of their income from both Israeli and foreign sources, including income they were not authorized to distribute to their Israeli resident beneficiary (ITO 1961, §75K(a)). It was also quite unclear how foreign trustees would react to the sudden imposition of extensive reporting requirements by the ITA. The authorities required full disclosure of the identities and residence of settlors, trustees, protectors, and beneficiaries, as well as of the data required to compute the capital gains tax that will become due when trust assets are eventually disposed of so as to trigger liability to such tax (§131(c1)). Such requirements contradict both the ethos and practice of many trust professionals. Their keeping settlors' and beneficiaries' identities secret has long been a core feature of the service they offer. Occasionally, the significance of the financial services sector to certain economies has brought about the statutory protection of that secrecy by making its infringement into a criminal offense, as in Switzerland (Swiss Penal Code 1937, §162) and Panama (Private Interest Foundation Law of Panama 1995, §35).

These two points and some others were eventually addressed by the ITA in early 2008. A further amendment to the ITO amended the new trusts taxation regime, which, despite having by now been in force for more than two years, had yet to be put into practice. The reporting burden imposed by the 2005 legislation was eased. The 2008 amendment permitted, where none of a trust's trustees were residents of Israel, the choice of one of its settlors or beneficiaries to bear the burden, normally borne by the trustees, of reporting to the ITA and paying the Israeli tax assessed on trust income and gains (ITO 1961, §75F1, inserted in Amendment no. 165). First suggested by the Israeli CPA Institute, this option was conceived so as to address foreign trustees' apprehensions regarding the regulatory consequences of taking on trusts involving Israeli settlors or beneficiaries. It also promised that even trusts administered by foreign trustees could provide work for Israeli professionals, as settlors or beneficiaries undertaking reporting and paying tax to the Israeli authorities are likely to engage a professional for this purpose. Regulations promulgated at the same time provided a means for allocating trust income, for tax purposes, between Israeli resident and foreign beneficiaries of the same trust, exempting income allocated to the latter from Israeli tax. Concurrently, the ITA, which has never admitted that irrevocable trusts were, until 2006, tax exempt, developed a "Proposed Tax Agreement" that offered trustees of irrevocable trusts an opportunity for resolving their trusts' tax liability for tax years 2005 and earlier, by paying a single lump sum, calculated as a certain fraction (between 4–10 percent) of the value of trust capital on December 31, 2005 plus distributions made between 2003–2005 (Draft Proposed Tax Agreement, Application and Procedure 2008). The facilitative bent of the 2008 amendments reflects the preeminence trust practitioners had by this point achieved in parliamentary discussions of trusts taxation. During discussion of the regulations at the Knesset Finance Committee, Tax Authority Director Yehuda Nasradishi was exceedingly responsive to Meir Linzen's comments and suggestions (Proceedings of the Finance Committee, the Knesset, May 5, 2008). Most importantly, the ten new forms required for the new regime to operate were finally published in June 2008. The forms having at this point been published exclusively in the Hebrew language, foreign trustees remained unable to fulfill the duties imposed on them. The reporting deadline for trusts for tax years 2006 and later was thus again, and repeatedly, postponed.

Later developments followed a similar course: professionals' complaints and proposals of ways for easing the burden of the regime continued to flow, as did the ITA's internal process of developing the administrative capacities necessary for operating it. Laxer's application of December 2005 was struck off the record in January 2007; a second, similar, application was denied in March 2009 (*Laxer v. Minister of Finance* 2009). A practitioners' handbook on trusts taxation, published in the summer of 2008, suggested that the new regime be given a free, "purposive" construction, narrowing the definitions of "revocable trust" and "settlor," extended as an antiavoidance measure, so as to catch only trusts created purely for tax avoidance purposes (Leibovich 2008, 424–31, 439–44). Criticizing the regime's imposition of reporting duties on foreign trustees, the author suggested that "legislation . . . presented at first as an attempt to create a paradise for Israeli resident trustees and another financial services market in Israel, as well as a tool for increasing the inbound flow of foreign funds, has at length been revealed . . . as a purely anti-avoidance initiative" (565–66). He prophesized that the regime's ambiguities would make wealthy foreigners, both individuals and charities, refrain from transferring their money to Israel and make Israeli settlors and beneficiaries neglect their reporting duties (565–66). The author pointed to an ideological contradiction (Halliday and Liu 2009, 914; Halliday and Carruthers 2009, 18, 418–19) at the heart of the new regime: it contains both pro-taxpayer and antiavoidance features. This fundamental contradiction, not corrected in the 2008 amendment and regulations, may drive future recursive cycles.

While Laxer and others railed against the imposition of extensive reporting requirements to the ITA, such requirements could serve local professionals well by either deterring their foreign competitors from taking on trusts entailing Israeli reporting obligations or driving those competitors to employ Israeli agents to take care of those obligations. Having been privy to the design of the new regime, accountant Alex Hilman, member of the Israeli Commission, called in December 2007 not for the curbing of reporting requirements, but for the removal of a remaining impediment disadvantaging Israeli trust professionals vis-à-vis their foreign competitors: an old section of the Income Tax Ordinance, applicable to Israeli assessees alone, which empowers the ITA to demand that trustees, being Israeli assessees, file a report regarding trust assets (ITO 1961, §135). Hilman called on Israeli professionals not to serve as trustees of international trusts until the ITA gave up this power as regards Israeli trustees of trusts deriving no taxable income in Israel (Magen 2007; Hilman).

The ongoing postponement dynamic lasted through 2009, with the final reporting due date for 2006 and 2007 being set for December 31, 2009. Bilingual versions of the forms were published in May 2009. The ITA having developed a new software package for processing trust-related reports and notices, the crucial internal directive, instructing ITA personnel on processing such information, was at length issued in January 2010 (Implementation Directive 1/2010).

That the new regime produced remonstrations on the part of some Israeli trust professionals was not surprising. Despite its pro-professional bias, the regime did bar at least one easy and effective planning technique that has long proved lucrative for such professionals: the sending of clients' money to jurisdictions abroad, to be placed with foreign trustees, free of Israeli taxes. The new regime replaced this easy, hitherto foolproof technique with a complicated barrage of reporting obligations. The more far-sighted professionals may have realized that the burden of such obligations would translate into remunerative work for trust professionals like themselves; others mourned the past tax opportunity. The different reactions of those professionals who were made part of the legislative process and those left to be passive recipients of the resulting regime may be partly attributed to this very difference between inclusion and the lack thereof. Some explanatory weight may also be attributed to differences between different professionals' client bases. The new regime largely exempted *foreign settlor trusts* from Israeli tax, a fact that may have contributed to the positive reaction of professionals serving such settlors. Those serving mostly Israeli settlors, actual and prospective, had, as we shall see in the next section, a more difficult task on their hands. Furthermore, the professionals involved in designing the new regime clearly did not invest, before or during engaging with the state, sufficient effort in what Halliday called "intraorganizational concertation" (1989, 407), the creation of support within their respective professional groups. As Halliday and Carruthers noted (2007, 1189), "disenfranchisement from participation in the design of treatment will lower its legitimacy for certain parties, reduce compliance, and engender resistance at the point of implementation" (see also Halliday and Liu 2009, 914).

Early Results

According to data provided by the ITA on January 1, 2012, 491 trusts had, by that date, filed reports with the ITA, 136 of which were administered by foreign trustees (Tax Authority letter to author). Filing continues apace: in an interview held on August 1, 2012, Moshe Asher, Vice-Director of the ITA, mentioned 560 reporting trusts, 160 of which are administered by foreign trustees (Asher). As for the "Proposed Tax Agreement" for resolving the tax liability of irrevocable trusts for tax years prior to 2006, opinions differ as to its success in driving disclosure of the existence of such trusts and of their assets to the ITA. Alex Hilman reports that many trustees have reached agreements with the ITA based on the terms proposed (Hilman) and Moshe Asher notes that these agreements have produced significant revenue (Asher). Alon Kaplan comments, however, that while about 360 of the 560 aforementioned reporting trusts predate 2006 and have reached agreements with the ITA as to their pre-2006 tax liability, thousands of other liable trusts established pre-2006 have yet to contact the ITA (Kaplan). Three tax experts interviewed in 2009 noted that as of that time, few trustees made use of the proposed agreement (Yuval Cohen, Ya'acov Cohen, and Gliksberg; Gabbay 2009, 27). Given that no informant appears to have had perfect information, the contradicting opinions are reconcilable, leading to a finding that the proposed agreement was taken advantage of by some, but not all, trustees of irrevocable trusts and that take-up has accelerated since 2009. Despite the low rates on offer, the imposition of those rates on the value of trust assets on December 31, 2005, plus that of distributions made between 2003 and 2005, resulted, given that tax was to be paid following the diminution in asset values consequent on the global financial crisis of 2007–, in what were, effectively, prohibitive rates: 4 or 6 percent of a large sum that was no longer available made a much larger fraction of the remaining smaller trust capital value. Under such circumstances, many trustees of trusts settled pre-2006 seem to have preferred the risk of a less generous tax regime being in future applied to pre-2006 trust income and gains over what, despite theoretically generous rates, was often a prohibitively large up-front payment (Gabbay 2009, 27).[3] Another cause of many trustees being slow to take up the "Proposed Tax Agreement" was the extensive disclosure of trust information the ITA required as a precondition for the opening of negotiations with a given trustee. Much of the required information was impossible, or very expensive, to obtain, while the negotiated result remained unpredictable even after disclosure. Many trustees and advisors fear that the ITA will share any information disclosed with foreign tax authorities, such as the US Internal Revenue Service (Kaplan).

A further result of the new tax regime is a transformation in Israeli professionals' trust practice. While the explicit exemption of *foreign settlor trusts* from Israeli tax largely confirmed an existing practice, trusts' major erstwhile selling point so far as Israeli settlors were concerned—the tax opportunity—has disappeared: the income of trusts settled by Israeli residents is now assessed as if earned by the settlor directly. Israeli practitioners serving the local "private client" market are thus currently aiming to educate their clients regarding the other benefits of trust use: protection of family property against spendthrift heirs, replacing the property distribution scheme provided by the law of intestacy with a bespoke alternative, and protection against foreign creditors and tax authorities (Shine). The media exposure given trusts practice as a result of the 2002–2008 legislative process seems to have increased practitioners' awareness of this field, leading to the entry of new practitioners (Hilman). Some practitioners now describe Israel, the high-taxing, foreign currency-controlling, emergency-levying jurisdiction of yesteryear, as a tax haven—a jurisdiction where one may save tax by *complying with*, rather than *avoiding*, its tax regime (Kaplan, Eyal, and Krost 2010, 141–42). Israel imposes no estate, inheritance, or gift taxes, and the companies tax rate it does impose has declined in recent years. Consequently, intentionally creating a trust subject to Israeli tax may result in overall tax savings for some multinational high net worth families.

Analysis

The evolution of Israeli trusts taxation in the last decade demonstrates Shamir's claim that "it is through formalization that the consistency needed for the institutionalization and objectification of a given order are established" (Shamir 1995, 172). The Israeli tax consequences of settling irrevocable trusts, previously unclear, were clarified and formalized between 2002 and 2008. Those consequences largely dictate the practicable boundaries of trust practice involving Israeli settlors, trustees, or beneficiaries. In clarifying and reforming those boundaries, professionals reformulated and preserved what was, for them, a lucrative source of income.

Despite the new tax regime's exempting of *foreign settlor trusts* from Israeli tax, intended to encourage the immigration of wealthy Jews by creating a tax-free channel for them to transfer their wealth to Israel, HNWIs are undeniably net losers under the new regime, compared with the antecedent status quo. *Foreign* settlors have not won any advantage they did not enjoy under the previous law, rather a formalization of

3. My use of findings by Daniella Gabbay follows express permission having been granted on September 26, 2011.

existing advantages. *Israeli* settlors have lost the benefits of an obvious, easily exploited tax opportunity: Israeli resident trusts were for many years not taxed in practice in Israel, and Israeli settlors' foreign resident trusts were until recently arguably tax free even de jure. Israeli trust practitioners, on the other hand, are clear gainers from the new regime, both as a matter of law and as a matter of practice. As for the law, Israeli trust practitioners stand to gain by (1) their Israeli residence having explicitly been stated to have no impact as to a trust's liability to Israeli tax, annulling foreign trustees' erstwhile advantage; (2) by the new regime regarding the underlying companies through which they hold trust assets as tax transparent and thus not liable to companies tax by reason of their shareholder/trustee's Israeli residence; as well as (3) by the very creation of the complex new regime, requiring the serving of a multitude of reports and notices and providing rich opportunities for amassing and exploiting expertise. Another practical benefit of the new regime for Israeli trust practitioners is that foreign trustees now refuse to serve trusts having an Israeli connection unless an Israeli agent takes care of the local tax authority's requirements; Israeli trust practitioners are happy to serve as such agents (Hilman). Further, the imposition of reporting requirements to the ITA benefits experienced tax practitioners at the expense of other potential trustees. Though the loss of Israeli clients' tax incentives for creating trusts increases the effort professionals must expend in selling trust services to their Israeli clientele, professionals appear to be net gainers from the new regime having been imposed, especially considering some Israeli trust professionals' characteristically international clientele. As Israeli trust professionals nearly always bill by the hour, the annual reporting burden imposed by the new regime has led to growth in their income from trust work, and that growth is itself likely to grow as more trusts start reporting to the ITA (Kaplan). As for the state, it stands, of course, to gain from additional tax revenue.

Israeli regulators have thus effectively driven a wedge between the regulated and their advisors, devising a tax regime that benefits both the state and professionals at the expense of the latter's clients. Regulators achieved this feat by designing the law so that retaining the services of local professionals is no less advantageous, from clients' point of view, than retaining those of their foreign competitors, while ensuring that compliance is complex enough to render it as profitable for professionals as avoidance used to be. Regulators thus split apart the usual coalition of advisors and their clients, creating in its stead a pro-compliance coalition of advisors and regulators. Considering the acuity of leading professionals and their considerable talents at "creative compliance" (for which, see McBarnet 1984; 1992; 1994; 2003; Picciotto 1992; Powell 1993; Dezalay 1995; Carruthers and Halliday 1998, 48), the devising of a tax regime so that compliance serves professionals' interests as well as avoidance used to serve them can be a useful strategy for increasing compliance.

Constructing compliance to be as profitable, from professionals' perspective, as avoidance can also encourage them to contribute to the legislative process so that their expertise redounds to the public interest, despite the legislative product being likely to have a negative impact on their clients' wealth. In outlining the conditions under which professionals may so contribute to such legislative processes, this article advances on Hoffmann's (1981–1982, 520–22) typology of circumstances under which the bar can be expected to act in an even-handed manner respecting a tax reform initiative. The Israeli trust taxation reform process conformed to most of the circumstances

Hoffmann mentioned: the extra-parliamentary Israeli Commission supplied the dispassionate, exclusive, tax expert environment he recommended (see a similar suggestion in Brint 1990, 372–73). Professionals responded positively to the ITA's choice of a collegial approach to tax reform: the previous wave of such reform, enacted in 2002, implemented many of the recommendations of a commission that, like the later Israeli Commission, included both government and professional members. The successful implementation of this earlier commission's recommendations, some of which reflected the efforts of its practitioner members, created an influential precedent for successful cooperation between the Treasury and professionals. The 2002 wave of tax reform included significant tax rate cuts, which created a nonadversarial context for trust taxation reform: the ongoing rate reductions demonstrated that the Treasury was serious about making Israel more HNWI- and business-friendly.

Still, compared with the 2002 reform, trust taxation reform was, going by Hoffmann's typology, less likely to foster "evenhandedness" on the part of professionals, or their successful cooperation with the Treasury in designing reform. The major thrust of trusts taxation reform was closing a tax opportunity from which professionals' client base drew significant advantages. The regime only included a modest pro-taxpayer step: it formally declared what was before 2005 an informal reality, that trusts foreign settlors created for Israeli beneficiaries were free of Israeli tax. Professionals' cooperation with the Treasury under such circumstances can be explained by two factors Hoffmann did not mention. One was that *professionals*—rather than their clients—received quid-pro-quo for the undermining of trusts as an avoidance technique: the new provisions were crafted so as to eliminate the advantages foreign trustees had previously enjoyed vis-à-vis Israeli resident trustees, as well as to introduce great administrative complexity, increasing the supply of professional work in the trusts field (Kaplan). The other factor was that opposition to the elimination of Israel's trust taxation gap was made difficult by opponents of reform having to openly justify a clear horizontal and vertical tax inequity. The US tax bar's contribution, early in the last decade, to governmental efforts at combating corporate tax shelter abuse can largely be explained by the same two factors. The reformed law put a premium on elite tax lawyers' expertise, at the expense of their competitors, accounting firms and less-skilled lawyers, who were posing, pre-reform, a real threat to elite lawyers' control of the tax field; and corporate tax shelter abuse is difficult to openly justify (Rostain 2006, 81, 105, 118–19).

I thus argue that the following set of conditions should be in place in order for professionals to be driven to contribute expertise to legislative processes so as to benefit the public interest, even at the cost of potential injury to the wealth of their client base. *First*, the creation of a dispassionate, exclusive environment of experts certainly helps bridge the gap between those experts serving the government and those serving private clients. *Second*, also advisable is the building of professionals' trust in government, by the latter's adoption of an explicitly collegial approach and, preferably, the granting of certain concessions to professionals' clients (if not as part of the current reform effort, then, as in the case under discussion, as part of previous efforts). *Third*, the legislative process in question should be concerned with rectifying a clearly inequitable status quo, thus making refusal to contribute difficult to justify. *Fourth*, the new regime should provide professionals with as many or more income-producing opportunities as the regime it replaces. One way of achieving this goal is by encouraging professionals to draft the new statutory language, which would later permit them to inform prospective clients that they, themselves, drafted that provision (Schizer 2006, 352; Ribstein 2004, 329–30). Some clients, at least, are likely to believe that professionals who drafted a statutory provision have superior skills in managing compliance with it. Another way to create demand for professional services under the new regime is by designing that regime so that compliance is burdensome enough to justify as large an investment in professional services as that made under the preceding status quo.

One reader of this article wondered whether, as increasing the complexity of the tax code is generally seen as a step in derogation of the public interest, purchasing professionals' participation in designing an antiavoidance measure with the coin of increased legislative complexity results in an overall public benefit. Seeing that the public interest in question is the equitable distribution of the tax burden between higher and lower income, more and less sophisticated taxpayers, a tax reform can be seen as conducive to the public interest if it results in an improvement to that distribution. By imposing tax on a set of sophisticated taxpayer strategies that have hitherto been effectively tax free, Israel's new trusts taxation regime is likely to make the distribution of the tax burden between more and less sophisticated taxpayers more equitable compared to the status quo. The new regime undeniably added complexity to the Income Tax Ordinance and raised the costs of compliance, both in introducing an intricate new set of provisions and in dramatically increasing trust users' reporting burden. Still, as the increase in compliance costs is likely to be much smaller than the tax take from the imposition of double-digit tax rates on trust income and gains, and considering that the increase in costs is itself subject to tax as additional income professionals earn, the new regime is likely to benefit the public interest, as defined above.

CONCLUSION

This article illustrated Rubin and Bailey's point (1994, 823) that "lawyers can act as rent seekers on their own behalf, as well as acting as agents for other rent seekers." I have described a case where government and professionals came together to change the law so as to injure the interests of professionals' clients, though not of professionals themselves. The article adds a unique link to the literature on professionals' norm entrepreneurship, in that the original motive for crafting the new regime was *not* increasing capital investments and demand for professional services, which were the motives for enacting many US LLC regimes, such as those of Florida, Colorado, and Kansas (Goforth 1995, 1221–23) as well as for the abolition or substantial weakening of the rule against perpetuities (RAP) in many US states (Dukeminier and Krier 2003, 1315). Nor was the regime I described pressed on the legislature by practitioners or their clients, like the LLC regimes of, for example, Wyoming, Utah, and Texas (Goforth 1995, 1220–21, 1224–26) and at least some instances of RAP abolition, such as Florida (Dukeminier and Krier 2003, n. 25). It was an antiavoidance measure. The ITA, rather than professionals or business-friendly politicians, initiated the drafting process. Once the ITA's lack of relevant expertise made it invite practitioners to join the drafting process, both ITA employees and private professionals contributed to the authoring of norms marrying professionals' interests and the public interest. Neither their clients' mouthpieces, nor high-minded, public-interested jurists, the professionals involved in the legislative process profited from the ITA's willingness to create a regime serving both an antiavoidance function and professionals' self-interest.

The article also provides a striking example of the absence of "jurisdictional competition" between professions under circumstances where such competition appeared, prima facie, to be likely. Why did lawyers and accountants cooperate rather than compete? (For lawyers' and accountants' jurisdictional contests, see Picciotto 1992; Sugarman 1995; Karpik 1999; Dezalay and Garth 2004; Rostain 2006). Carruthers and Halliday provide a partial answer:

> When specialists in several professions work together on a problem . . . stable networks of association are likely to result in the formation of a *trans-professional community*. When the work is highly specialized, and its technicality makes access difficult to non-specialists, the trans-professional community can forge a stronger internal identity than each of its members has with his or her respective professions. Such trans-professional communities are relatively common. (1998, 454)

Estate planning being a paradigm case of highly specialized, technical work, the community of trust professionals and private wealth planners has, arguably, become such a trans-professional community. Israeli trusts and estates practitioners often see themselves as "client carers" rather than as lawyers or accountants per se (Hilman). They have both legal and accounting skills themselves, partner with or employ persons having the skills they lack, or purchase such skills outside their firm. Both skills are currently in great supply in Israel. Competition for clients is intense, but it is rarely formulated as competition between professions; rather, all trust professionals, whether lawyers, accountants, bankers, or others, vie with each other for clients. Another cause of the lack of interprofessional competition in Israeli trust practice is market expansion (Carruthers and Halliday 1998, 496). The last fifteen years have seen several events trigger increased demand for trusts and estate planning in Israel. The sine qua non was a great wave of newly affluent Israelis, starting in the mid 1990s. Its effect was compounded by the near-demise of currency control in 1998, an estate tax scare during 2000, and the 2002 tax reform, which first imposed Israeli income tax on income Israeli residents earned abroad and inserted controlled foreign corporation rules in the Israeli Tax Ordinance.

Halliday and Carruthers having comprehensively described the recursivity phenomenon, this article raises further questions, pointing toward a wider research agenda concerning professionals' contributions to legislative processes and the motives behind those contributions. Are state norms formulated by both state and professional actors more, less, or equally liable to later "creative compliance" by professionals than norms formulated by state actors alone? Given that professionals are central actors in implementing any statutory regime, does involving them in the legislative process reduce "actor mismatch" (Halliday and Carruthers 2007, 1152; 2009, 383–85) and, if so, what are the costs of that reduction (e.g., tax opportunities built into the law)? Under what circumstances should professionals' involvement in such processes be seen as part of an avoidance or evasion project, rather than as a bona fide contribution to creating norms in expectation of compliance with both the letter and spirit thereof? When professionals, politicians, and civil servants collaborate on a legislative project, to what extent are each group's contributions intended to provide it with a toolbox for later achieving goals that are at odds with those of one or more of the others? Concededly, each group of contributors to legislative processes can have multiple, and possibly conflicting, motives. Public servants may both serve the public interest and want relationships with leading practitioners, to enable a move to the private sector. Professionals may simultaneously wish to serve the public, their clients, and their own long-term interests (Carruthers and Halliday 1998, 55–56, 533–34). In such mixed motivation cases, what impact does the legislative process have on each participant's framework of contrasting motivations? Which motivations are emphasized, which marginalized? All these questions await future work.

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