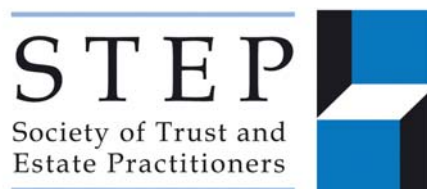


Guide to the Israeli Tax Benefits Granted to New & Returning Residents

Prepared for clients and prospective clients of
Anglo Capital Limited.



Distributed in Association with



Jerusalem Branch

1st edition – June 2010

Guide to the Israeli Tax Benefits granted to New & Returning Resident

A summary of Israeli tax information

This is a compilation of unofficial & non-binding translations of various documents originally published in Hebrew and is based on our understanding of Israeli law, legislative proposals and current practice as at June 2010.

This guide is intended to provide a general guide to the subject matter and should not be regarded as a basis for ascertaining the liability to tax or legal opinion in specific circumstances.

In such instances, separate advice should be taken.


This document can also be found on the Anglo Capital Limited website at: www.anglocapital.com

© Anglo Capital Limited, Israel.


Anglo Capital Limited
International Wealth Structuring

אנגלו קפיטל בע"מ

Investment
business
placed via



Pioneer
Global Funds



ac
anglo
capital
limited

Contact Details:
Philip Braude
AICPA International Affiliate (US)
Chartered Certified Accountant (UK)
Personal Financial Planner : AICPA (US)
Fellow of the Securities & Investment Institute (UK)
Trust & Estate Practitioners (UK) – Chairman Jerusalem Branch
Investment Marketer Licensed by the Israel Securities Authority

| Tel: +972-2-992 1519 | Fax: +972-2-991 6901 | Email: pbraude@anglocapital.com |

Website: www.anglocapital.com

**Unofficial Translation of Income Tax Circular XX/2010 – Professional,
International Tax Unit**

**An Analysis of Amendment 168 to the Ordinance - Tax Reliefs to New
Immigrants and Returning Residents – Part A**

- 1. Table of Contents¹**
- 2. Forward**
- 3. Beginning Directives**
- 4. Definitions**
 - 4.1 Israeli Resident for the First Time
 - 4.2 Veteran Returning Resident
 - 4.3 Returning Resident
 - 4.4 Year of Adjustment
 - 4.5 Israeli Resident in Respect to a Corporation
 - 4.6 Foreign Resident in Respect of the Individual
- 5. Tax Benefits Given to New Immigrants and Veteran Returning Residents**
 - 5.1 Exemption on Profitable Income – Chapter 14(a) of the Ordinance:
- 6. Residents' Profile**

2. Forward:

The Income Tax Ordinance (henceforth: the ordinance) and the amendment strengthen the various directives regarding tax for new immigrants and returning residents. On 16 September 2008, amendment 168 of the income tax ordinance (henceforth: the amendment) was published, including expansion of the tax reliefs on new immigrants' and returning residents' income.

In the foundation of the law is a broad program encompassing the primary goal-immigration absorption, human capital recall qualitative to Israel and investment incentives for individuals with financial potential to change Israel into their center of life, from the goal of immigrating to Israel and investing in developing economic power. An additional goal is the creation of functional simplicity and certainty, from the tax disposition, in association with new immigrants and returning residents.

According to information from the absorption ministry, on the eve of the amendment, one of the deterring factors for an immigrant to move his residency to Israel is the uncertainty of his tax standing emanating from questions regarding residency, causing friction between him and the tax authority.

¹ Examples and names appearing in this circular are fabricated and have not been referred to in actual situations with the tax department

Therefore, the ordinance comes to lessen the doubts and to encourage their return or immigration to Israel, to reduce friction with the tax authority regarding questions arising from lack of certainty as aforementioned.

The essence of the law in a nutshell is as follows:

- Comparison of tax standing of someone who ceased to be Israeli resident for at least 10 years (henceforth – **veteran returning resident**) to the status of a new immigrant regarding income whose source is outside of Israel as detailed in the amendment.
- Expansion of the exemption given to new immigrants and veteran returning residents that will apply to income generated from outside of Israel, 10 years from the day they became Israeli resident; in addition, expansion of the exemption regarding foreign assets garnered after immigration or return to Israel regarding a new immigrant or veteran returning resident.
- Exemption of reporting foreign income that a new immigrant or returning resident produces during the aforementioned grace period;
- Extension of the minimum postponement period from outside of Israel that provides tax exemption benefits to regular returning residents (extension from 3 to 6 months).
- Broadening of the scope of exemption given to a regular returning resident regarding income whose source is “preferred stock”. Other exemptions established in the ordinance regarding a regular individual returning resident remain.
- Parameters of a “returning resident” regarding an individual or a corporation under governance of new immigrants or veteran returning residents during the benefit period, whose goal is to prevent restrictions of business proceedings from tax considerations, were established.

3. Beginning Directives

In principal, the amendment’s directives begin from 1 January, 2007 (henceforth: “**beginning day**”) in these instances:

1. On income from an individual who returned to Israel with veteran returning resident status or immigrated to Israel as a new immigrant beginning from the first day onward;
2. On income from a regular returning resident from preferred stock, only returning to Israel after beginning day and having remained outside of Israel 6 years minimally as a foreign resident.
3. The new parameters of “foreign resident” apply to someone who left Israel on beginning day and onward and not to someone who left prior to beginning day and if returned to Israel from beginning day and onward. But, regarding one who arrived in Israel as a veteran Israeli resident or a new immigrant, even if he left prior to beginning day as long as he returned on beginning day and onward.
4. New immigrants and returning residents who changed to Israeli residents prior to beginning day, will continue to benefit from the reliefs as established in amendment 132 of the ordinance and detailed in the income tax circular 17/2002.

4. Definitions

4.1 Israeli resident for the first time:

An individual that became Israeli resident and was not Israeli resident previously (henceforth: **“new immigrant”**).

4.1.1 Period to see an individual as transformed to Israeli resident:

Israeli resident parameters, appearing in chapter 1 of the ordinance, establish an individual who has his center of life in Israel for the tax year as Israeli resident for that year. To establish central place of his life, you must take into consideration familial, economic and fraternal ties (henceforth: **“essential parameters”**); included amongst others: (a) location of his permanent house; (b) place of residence for he and his family; (c) his regular or permanent place of business or employment; (d) place of his operative and qualitative financial interests; (e) location of his organizational activities, in various societies and institutions; for the definition determines that the preemption of an individual’s center of life in Israel (A) if he remained in Israel for at least 183 days during the tax year; (B) if he remained in Israel 30 days or more during the tax year, and the total period that he was in Israel for the tax year and the two years proceeding was at least 425 days; (henceforth: **“quantitative parameter”**).

The goal of the essential and quantitative parameters is to delineate lines characterizing an individual as having an Israeli affinity to view him as her (Israeli) resident.

For the purpose of realizing the law’s intention and to produce certainty and clarity to questions pertaining to the period that the individual transformed to Israeli resident (regarding essential parameters), we found that to detail the existing conditions you must see the individual as having brought his center of life to Israel.

Therefore, it has been established, that on the day the individual, who up until that day had been foreign resident, came, will be considered to having brought his center of life to Israel, will be the earliest period from the alternative periods detailed below:

Alternatives 1 and 2 based on the clauses (a) (1) (a) and (a) (1) (b) defining Israeli resident

1. Regarding an individual that has no family (in this instance: “family” – spouse and children that are younger than 18) and has a house in Israel, whether he owns, is renting or has right to its use (henceforth: “**permanent home**”), beginning from the period the house was used for residence.

Regarding this issue – one must see the day that the actual period of residency began, that the individual started using this as his permanent home. For example, a residential period of 90 days every tax year for 4 consecutive years will be considered as a qualitative period.

2. Regarding an individual with a family who has, or his family has, a permanent home in Israel available for personal use whether he owns, rents or has usage rights, and the family is with the individual in Israel, the period begins from the time the home became their permanent residence.
3. The day he is classified as new immigrant or returning resident, according to the absorption ministry criteria and as appears on the new immigrant certificate or returning resident certificate, issued by the absorption ministry.

Supposedly, aforementioned alternatives 1 and 2 are based on the clauses (a) (1) (a) and (a) (1) (b) defining Israeli resident. We will emphasize, that circumstances wherein the clauses (a)(1)(c) through (a)(1)(e) (different relationship tying an individual to Israel aside from permanent home and/or place of his family’s residence) and that which is stated in clause (a)(2) defining Israeli resident (“essential parameter”) you can learn from them that an individual’s and/or family’s center of life is in Israel, and at an earlier period, even if the 1st and 2nd alternatives will point to different results.

We must indicate, to establish Israeli residency for an individual, you must grade the variables mentioned, regarding establishing the individual’s center of life, with the directions in paragraph (b) defining foreign resident (see reference in paragraph 4.6). In the same instances where the individual’s center of life in Israel for the first two years (example, he has a permanent home in Israel), but he lived in Israel less than 183 days every year, you cannot say that he was Israeli resident for the first two years if it became clear that in the third and fourth he no longer had a center of life in Israel.

4.2 Veteran Returning Resident:

An individual who returned and became Israeli resident after being foreign resident for at least 10 consecutive years.

4.2.1 Temporary Provision:

As an incentives for former Israelis to return to Israel in the framework of the Israel's 60th anniversary celebration, a temporary provision was established whereby a veteran returning resident will be an individual returning during the 2007,2008, and 2009 tax years, providing he was foreign resident for at least five consecutive years before his return to Israel.

4.2.2 Coming into Effect:

The definition of a veteran returning resident will apply to an individual that returned and became Israeli resident from the beginning day (1.1.2007).

4.2.3 Explanation:

The definition of a returning resident in paragraph 14(c) of the ordinance, to be amended, relates to anyone ceasing to be Israeli resident and remained outside of Israel on a permanent basis for a period of at least three years. A returning resident was entitled to fewer perks and exemptions relative to the perks and exemptions entitled to a new immigrant. This definition is being amended; it didn't differentiate between an individual ceasing to be Israeli resident and remaining abroad for a considerable period of time to an individual remaining outside of Israel for a couple of years. In the amendment, a new classification has been established for returning residents after being foreign resident for a minimum of ten consecutive years.

The temporary provision to the amendment established, regarding an individual who reverted to Israeli residency from 2007-2009, a minimum 5 year period foreign residency (in place of the aforementioned 10 years), for obtaining the status of veteran returning resident. The purpose of the temporary provision is to provide a "window of opportunity" to individual foreign residents, remaining abroad for a few years, to return "home" without having to wait ten years from the time they left Israel. This initiative is incorporated within the benefits and services granted by the absorption ministry under the framework "Returning home for Israel's 60th" encouraging the return of former Israelis abroad.

4.2.4 Examples:

See as an example residents' profiles in paragraph 6 of the circular.

4.3 Returning Resident:

An individual who returned and became Israeli resident after being foreign resident for a minimum of six consecutive years.

4.3.1 Coming into Effect:

The definition of returning resident is indicated regarding increase of the number of years the individual is considered foreign resident – from three to six – as was established in the amendment, will apply only to individuals ceasing to be Israeli resident starting from 1 January 2009.

4.3.2 Explanation:

If the individual ceased being Israeli resident from 1.1.2007 until 31 December 2008(inclusive), it is sufficient for the shortened period of three years required for returning resident to be considered a returning resident as he would have according to law proceeding the amendment. On the other hand, an individual ceasing to be Israeli resident from 1 January 2009 onward, requires a longer period of time, six years as foreign resident, to be considered returning resident.

Regarding the Definition of Foreign Resident see Paragraph 4.6 of This Circular

4.4 Year of Adjustment

The decision to move a place of residence is complex based on many considerations. Taken into account in this decision, amongst others, are tax implications emanating from the move which may cause obstruction and obstacles for someone making the decision or to phase in the groundwork which will magnify its scope and undermine the security in its acceptance.

Paragraph 14(b) of the ordinance establishes a mechanism that is meant to neutralize doubt emanating from the aforementioned tax implications, regarding an individual's decision to immigrate or return to Israel.

The mechanism gives the new immigrant or returning resident (henceforth: **“beneficiary”**) the opportunity to continue being considered foreign resident for one year from the time he immigrated or returned to Israel, as per the case, according to his notification (henceforth: **“year of adjustment”**).

4.4.1 Notification

One who chooses this alternative must give notification within 90 days of his arrival to Israel, in the form attached to this circular as appendix A to the absorption ministry because certain conditions exist whereby he is considered Israeli resident and that he requests the year of adjustment.

4.4.2 Day of Arrival in Israel:

On 2.3.09 Assistant Director General Becher published a letter detailing the conditions regarding professional issues whereby an individual is seen as arriving in Israel. The purpose of the letter was to delineate certainty regarding the individual's notification of his choice for the year of adjustment and to establish the period in which 90 days of counting for submission the request for the year of adjustment. This period is defined as "**arrival day in Israel**".

In paragraph 4.1.1 above, in the period in which the individual moves his center of life to Israel he becomes Israeli resident. To combine "day of arrival in Israel" and submission of the year of adjustment request, with this period classifying the individual as Israeli resident; this letter updates the directive as follows:

This period in accordance with the period the individual arrives in Israel with intention of selecting one of the alternatives detailed in paragraph 4.1.1.

Due to the fact that the alternatives in paragraph 4.1.1 have repercussions on the past, there is importance in the intention of the notification. In the instances whereby there was no intention but in practice the move exists, the director of the tax authority has the option to delay the period of notification.

4.4.3 The Meaning of the Year of Adjustment

The meaning of the year of adjustment is that the beneficiary will be considered foreign resident for Israeli tax purposes for one year following the day of his arrival to Israel.

Below are a number of options for the beneficiary to choose:

- The beneficiary who opted for the year of adjustment will be considered foreign resident. In addition, if he leaves Israel during the course of the year he will be considered as not having originally immigrated or returning to Israel.
- The directive paragraph 100a of the ordinance will not apply to the beneficiary opting for the year of adjustment and leaving Israel during that same year.
- During the year of adjustment, the beneficiary's holding in a corporation will be considered as a foreign resident with the same holdings, this among other things – as per the definition "company of foreign investors" or "foreign investment company" as they pertain to law encouraging capital investment, as per the definition "foreign business company" in paragraph 5(5) of the ordinance or definition "foreign controlled company" in paragraph 75b of the ordinance.
- The beneficiary is entitled during the year of adjustment to exemptions granted to foreign residents, for example – exemption for a foreign resident on capital gains as per paragraphs 97(1b)-(3b) or exemption to a foreign resident on interest from bank deposits as established in amendments.

- The beneficiary will be entitled to benefits as a “foreign specialist” from the strength of the income tax amendments (expense deductions for foreign resident), 1979
- A beneficiary will not be entitled during his year of adjustment to be authorized as Israeli resident or resident of the area and therefore the directives for arts preclusion to double taxation for Israeli residents will not apply to him.
- The beneficiary will not be entitled during his year of adjustment to the entitlement points given to an Israeli resident as per chapter three part c.

4.4.4 Clarifications:

a. During the year of adjustment an individual will not get authorization as Israeli resident for tax.

b. If during the year of adjustment the individual will decide to shift his residence to Israel, the year of adjustment is reckoned in with the counting of years for the exemption period as per the ordinance. Conversely, if during the year of adjustment the individual will decide to move his residence abroad he will not be considered Israeli resident during his year of adjustment.

c. If at the conclusion of the year of adjustment the individual continues to reside in Israel, his status as beneficiary will be from the day of arrival in Israel and not with the completion of the year of adjustment.

For example, an individual returns to Israel in 2009 after remaining abroad for 5 years (temporary provision) and he opted for the year of adjustment to be deemed foreign resident. Clearly, after completing the year of adjustment and continuing to dwell in Israel, one must see him as converting to Israeli resident retroactively from 2009 regarding the status of veteran returning resident. Determining otherwise, that he became Israeli resident only in 2010 will prevent an individual from being considered veteran returning resident as per the temporary provision regarding the option of the year of adjustment.

d. On the other hand, the year of adjustment will not be counted as part of the years classifying the individual as veteran returning resident, in instances where he chose to move his residence abroad and requests to once again return to Israel afterward. In this instance, the year of adjustment will not impinge on the continuity period required to be deemed foreign resident. Take for example an individual who returned to Israel in 2009 after being abroad for six years (temporary provision) and decided in the year of adjustment to change his residence and move back abroad. This same individual who in 2015 decides to return to Israel must be seen as returning to Israel following a stay of 12 “consecutive” years abroad.

e. A beneficiary who did not give notification in time (within 90 days) cannot do so at a later period unless otherwise authorized by the tax authority director as detailed in paragraph 4.1.1 of this circular.

f. A beneficiary who opted for the year of adjustment cannot change his decision.

4.4.5 Examples:

See for example the residents' profile in paragraph 6 of the circular.

4.5 Israeli Resident as per Corporations:

4.5.1 Definition Eve of the Amendment:

Paragraph 1 of the ordinance determines the definition of "returning resident" regarding an individual and regarding a corporation. "Israeli Resident" regarding a corporation is defined as fulfilling one of the following:

- (1) Incorporated in Israel
- (2) Control of transactions and their management occur in Israel

4.5.2 Definition Additions Following the Amendment:

Established within the amendment framework, if the control of transactions of the foreign company and its management occur in Israel by a new immigrant or veteran returning immigrant or on their behalf, and 10 years from the time the new immigrant or returning veteran resident came to Israel, providing that this same corporation was not classified as Israeli resident even if its management and transactions did not operate in Israel by the same individual or on his behalf.

4.5.3 Explanation:

Without establishing this, the tax exemption for a new immigrant or veteran returning resident would be granted only if his entrance was as an individual. Meaning, the exemption would be denied if the new immigrant or returning veteran resident was the controlling stockholder of the company, in this way the corporation would be seen, without the amendment, as an Israeli resident company (from the managerial perspective) not entitled to exemptions granted to new immigrants and veteran returning immigrants. The possibility of moving the management and governance of international companies to Israel, without fear of classification as an Israeli resident company, on one hand coming for the purpose of developing the Israeli economy and from the other hand to give the new immigrant or veteran returning resident security that he can continue to direct as he has in the past.

4.5.4 Clarifications:

a. The amendment allows a corporation governed by a new immigrant or veteran returning resident to be deemed an Israeli resident corporation.

4.5.5 Examples:

a.

b. Michele, previously Israeli resident, left Israel in 1993 and settled in France. Michele is the proprietor and director of a travel agency established in France in 1994 and managed from Paris (henceforth – “**the company**”). On 1 January 2008 Michele returned to Israel and became a veteran returning resident. On the day of his return, he transferred the operations of the company to Israel, appointing Israeli directorate and management and established its offices in Israel.

In accordance with the amendment, despite that the control of business of the foreign company and its management operate in Israel by someone on behalf of Michele, the company will not be deemed Israeli resident from 2008-2017(inclusive). In addition, the income from this company generated from Israeli business will be liable to Israeli tax.

4.6 Returning Resident as per an Individual:

4.6.1 Definition Eve of the Amendment:

Paragraph 1 of the ordinance, eve of the amendment, defines “foreign resident” as a residual definition, meaning someone not considered Israeli resident. It should be noted that this definition is relevant even after the amendment and “foreign resident” is anyone not considered “Israeli resident, someone whose center of life is not in Israel beginning from that date.

4.6.2 Addition to the Definition Subsequent to the Amendment:

For delineation and certainty regarding the time of termination of an individual’s residence, updated definition of foreign resident, in paragraph 1 of the ordinance and additional definition included in the two accumulated tests, the quantitative test and the qualitative test:

In instances where the individual remained outside of Israel for at least 183 days a year, during the tax year and the successive tax year (henceforth: **the quantitative test**) and the two years following his center of life no longer remained in Israel (henceforth: **the qualitative test**), he will be considered as a foreign resident from the day he left Israel during the first tax year that he remained abroad for 183 days.

4.6.3 Clarifications:

a. The Relationship between the Definitions Israeli Resident and Foreign Resident –

“Israeli resident” is defined in paragraph 1 of the ordinance as having his center of life in Israel. One of the preemptions is having spent a minimum of 183 days in Israel. Nonetheless, certain instances exist whereby the individual’s center of life is in Israel even though he spent less than 183 days (i.e. close to his leaving). From here the question arises, from when does an individual’s Israeli residence cease and become foreign resident?

The definition of foreign resident is integrated with maintaining the center of life and establishes for cessation of residency, the question of maintaining the center of life is overlooked for the first two tax years providing he remained outside of Israel for 183 days each tax year and the two subsequent tax years his center of life was not in Israel. **See examples a & b following.**

b. Calculation of the number of days outside of Israel – for the purpose of counting days he remained outside of Israel, as per the quantitative test, you must deduct the days remaining in Israel from the days of the year. Regarding this “**number of days remaining in Israel**” – part of a day will be seen as a day, as stated in paragraph 1 of the ordinance. **See example c below.**

c. Without contradicting the clarification aforementioned in paragraph a, it is clear that in circumstances when the individual left Israel during the tax year, the quantitative test’s subsistence must be examined against the calendar tax year. Therefore if during the tax year that the individual left Israel, he had remained outside of Israel for less than 183 days, the counting of the four years will begin, at least, in the subsequent year as well as the day of cessation of residency. If during the same tax year the individual left Israel he remained outside of Israel for more than 183 days, the four years shall start with the year he left and cessation of residency from the day he left and not from the beginning of the tax year that he remained outside of Israel for 183 days. **See examples d through f below.**

d. It should be emphasized that for establishing individuals’ residency during a certain tax year and for determining status as returning resident or new immigrant, you must consider what is stated in the amendment from the force of paragraph 1 of the ordinance (establishing individuals to be seen as Israeli resident and establishing individuals not to be seen as Israeli resident), 2006. However, it should be emphasized that in instances where usage of the amendment in a manner not intended; application should be evaluated.

e. Coming into Effect –

Below are the alternatives for the onset of “foreign resident” (following amendment 168):

1. an individual who left Israel on 1 January 2007 and onward
2. an individual who returned to Israel on 1 January 2007 and onward on condition that he is deemed veteran returning resident upon his return. Take for example, an individual who remained outside of Israel from 2002-2003 exceeding 183 days and during 2004-2008 his center of life was outside of Israel.

The definition of foreign resident will not apply to an individual who returned to Israel prior to 1.1.2007 and not to an individual returning after 1.1.2007 without the classification of veteran returning resident. Take for example, an individual who left in 2006 and returned in 2010 cannot be deemed a veteran returning resident and therefore foreign resident cannot apply to him.

f. An individual who left Israel and since, four years have passed from the date of his departure but it cannot be determined with certainty cessation of residency on the day of his departure, he should refer to the assessing

officer where he resides to establish tax obligations applying to him during the years he was abroad until establishing his status as foreign resident in accordance with the definition.

4.6.4 Examples:

a. Avi left Israel, initially, on 1 January 2008. During 2008-2009 he didn't remain in Israel for more than 80 days each year albeit his center of life remained in Israel. During 2010-2011 Avi was not in Israel.

During 2008-2009, the center of Avi's life must be seen as being in Israel. 2010-2011 there is no doubt that Avi's center of life was not in Israel. The definition of foreign resident allows Avi to be seen as foreign resident from 2008 (even though his center of life was in Israel that year).

b. Avi left Israel, initially, on 1 January 2008. During 2008-2009 he didn't remain in Israel for more than 80 days each year albeit his center of life remained in Israel. During 2010 Avi was not in Israel but returned to Israel on 1 January 2011. During 2008-2009 the center of Avi's life can be seen in Israel. Avi did not fulfill the requirement in the foreign resident definition requiring cessation of Israeli residence in 2008 and therefore can only be seen as ceasing residence in 2010.

c. Avi left Israel initially for Europe on 1 January 2008. Avi is accustomed to return to Israel Every Friday and leave every Sunday.

The number of days Avi remained in Israel during 2008 were 156, including days of arrival and departure (Fridays and Sundays). The number of days Avi remained outside of Israel was 209 ($365-156=209$).

d. Avi initially left Israel on 1 September 2007. During 2008 he returned for visits and remained in Israel from 1 October 2008 until 1 March 2009. During 2010-2011 the center of Avi's life wasn't in Israel.

In accordance with establishing foreign resident and its clarification in paragraph 4.6.3 Avi will be classified as foreign resident from 1 January 2008.

e. Avi initially left Israel on 1 April 2007 and remained abroad until 1 April 2008. In 2008 he stayed in Israel from 1 April 2008 until 1 September 2008. Avi's center of life during 2009-2010 was not in Israel.

With regard to the definition of foreign resident and its clarification in paragraph 4.6.3 Avi will be deemed foreign resident from 1 April 2007 and not from 1 January 2007.

f. Avi initially left Israel on 1 April 2007 and remained abroad. On 1 July 2007 he returned to Israel and stayed until 1 September 2007. During 2008, 2009-2010 the center of Avi's life wasn't in Israel.

With regard to the definition of foreign resident and its clarification in paragraph 4.6.3 and on assumption that it can be proven that Avi visited Israel during July and August 2007, solely for summer vacation, Avi will be considered foreign resident from 1 April 2007.

5. Tax Benefits Granted to New Immigrants and Veteran Returning Residents

5.1 Exemption on Profitable Income – Paragraph 14 (a) of the Ordinance:

5.1.1 The Law on the Eve of the Amendment:

In accordance with law applying on the eve of the amendment, one considered to be a new immigrant or returning resident would be entitled to a tax exemption on passive income (interest, compensation, dividends, annuity and rent) from income garnered abroad prior to his immigration / return to Israel; a new immigrant (only) was entitled to an exemption, for a period of 4 years, on income from business abroad providing the business was in operation for a minimum of 5 years prior to immigration.

5.1.2 Broadening of the Exemption Following the Amendment:

Paragraph 14(a) of the ordinance as per the version following the amendment grants the new immigrant and veteran returning resident a tax exemption for a 10 year period from the date they became Israeli resident on income from all sources enumerated in paragraphs 2, 2a, or 3, which were generated or produced outside of Israel or their source, an asset outside of Israel, unless otherwise requested regarding all or partial proceeds.

5.1.3 Explanation:

As stated, the amendment broadens the exemption and comprises all income of a new immigrant or veteran returning resident, generated abroad, for 10 years from the day of immigration or return, in a manner including all current income (active and passive) whether the source was from income prior to becoming Israeli resident or after immigrating or returning to Israel, this for a 10 year period (regarding capital gains see paragraph 5.2 below).

This is a substantial change, for, according to the amendment, income from foreign assets, acquired after the date of immigration or return will entitle the individual to be tax exempt whereas according to the old law income from these assets was not tax exempt.

5.1.4 Initial Directives and their Coming into Effect:

a. Directives paragraph 14(a) as per its version subsequent the amendment apply only to one who became a new immigrant or veteran returning immigrant from beginning day and onward.

b. New immigrants and returning residents that became Israeli resident prior to beginning day will continue to benefit from the reliefs established in paragraph 14 as per the version on the eve of the amendment.

5.1.5 Annotations and Clarifications:

a. An asset received as a gift – It should be emphasized that the amendment determines the aforementioned classification, if the asset producing the income is transferred to the new immigrant or veteran returning resident as a tax exempt gift as per paragraph 97 (a) (5)

following beginning day, the income produced from the asset will not be entitled to tax benefits.

b. An inherited asset – The exemption mentioned in paragraph 14(a) applies to income produced or generated from a foreign asset inherited by a new immigrant or veteran returning resident even after the date he immigrated to Israel.

c. Waiving the exemption – According to paragraph 14(a) there is an option to waive the exemption granted to a new immigrant or veteran returning resident and tax his current income according to law. It must be emphasized that the option of omission is because income will be tax exempt by an individual only if another assessing officer is notified. Notification of the waiver of the exemption will be passed to the assessing officer prior to the onset of every tax year.

d. Mixed activities – In instances where a new immigrant or veteran returning resident generated income from personal exertion, and this income resulted from mixed activities, partly executed from Israel and partly from abroad (henceforth: **mixed activities**), the portion of income produced from Israel is not entitled to the exemption established in paragraph 14(a), because it was produced in Israel. To receive the exemption on income produced abroad, an individual has the option to have the income produced from mixed activities divided according to the number of working days the individual remained outside of Israel during the year in relation to working days in the year.

In choosing working days, regarding the entire year, the individual must determine whether to include one of the days, either Sunday or Friday, and this will apply to the entire tax year and the following tax year. It should be emphasized that when counting working days, vacation and personal travelling should not be taken into account.

If the individual does not have to report his income from outside of Israel, it is not subject to tax, and his present work which is taxable and requires reporting in the realm of mixed activities, it is incumbent upon him to report that the division of mixed income and its derivatives were executed in accordance with the aforementioned and to present the detailed calculation if required to.

It should be indicated that the above manner proposed for division of income from mixed activities as detailed in this directive is from the origin; but the individual who exercises the option of proving to the assessing officer a different result, as long as he took the proof regarding the level of income from mixed activities applying to the individual, thereby satisfying the assessing officer.

If the individual wishes to evaluate the portion of his mixed activities that is taxable in Israel, and in order to allow the assessing officer to assess his income taxable in Israel, the assessing officer has the right to every account, report or ledger even if they include income exempt from tax according to the amendment directives. **See example e below.**

Regarding foreign tax credit, it should be emphasized, that in the instance when a portion of the mixed income generated from abroad is exempt from tax as per the directive in paragraph 14 of the ordinance, it should not be included with the portion of foreign tax allowance paid abroad.

Restrictions - It is indicated, that when the individual's mixed income is generated from outside of Israel over a short period of time which renders his activities outside of Israel secondary to his activities in Israel, the income must be seen as if produced in Israel, from the aspect "secondary follows primary". **See example f in paragraph 5.1.6 below.**

e. Overseas Work for an Israeli Employer – An immigrant or veteran returning resident who was sent by his employer, who is Israeli resident, to a foreign country to do work for limited periods of time, the income for this work will be seen as integral income to his work in Israel and therefore seen as income generated in Israel and not entitled to tax exemption from paragraph 14(a) of the ordinance. **See example g 5.1.6 below.**

f ...

g. Impact on Foreign Investment Company – Paragraph 47 (1a) (b) of the law encourages capital investment regarding foreign investment companies. It establishes that a new immigrant be considered foreign resident for the beneficiary period when investing abroad even regarding the amount of foreign investment. This is for the purpose of upcoming legislation easing the new immigrant's treatment of his foreign income only. These directives apply to a first time Israeli resident only.

h. Foreign Asset – Paragraphs 14(a), 14(c) and 97(b) establish that an individual's income whose source from "foreign asset", be tax exempt. Clearly, a foreign asset includes amongst others, securities as defined in paragraph 88, of a foreign resident company or a bond issued by a foreign country whether traded on the Israeli exchange or outside of Israel, whether held in Israel or outside of Israel. It is emphasized that securities of an Israeli company or a bond issued by the State of Israel, are deemed Israeli assets without any connection to the place traded or held.

i. Dividends Paid by a Foreign Company – Paragraph 14(a) establishes, amongst other things, that the individual's income, that was generated or grew outside of Israel, will be tax exempt, indicated because dividends paid by a foreign company and income from which the distributed dividend is produced for Israel, should not be seen as income whose source is outside of Israel and the directives of paragraph 14(a) do not apply.

5.1.6 Examples:

a. Roz, a former American resident, immigrated to Israel for the first time on 1 January 2008. Roz is employed as a surgeon in a hospital in the U.S.A. Similarly, Roz owns shares in an American pharmaceutical company (henceforth: “the company”). Roz does not work for the company.

During the year, Roz generates income from his hospital salary and his dividends distributed by the company.

According to paragraph 14(a) Roz is only tax exempt on salary and income from dividends, while being a new immigrant, between years 2008-2017 inclusive.

b. Continuing with this example, Roz returned to Israel on 1 January 2008, after being considered foreign resident from 2004-2007 inclusive.

For work where Roz was considered foreign resident for six continuous years until his return in 2008, he can be deemed veteran returning resident as per the temporary provision and entitled to the exemption stated in paragraph 14(a). Meaning, Roz will be tax exempt on dividends and salary for a ten year period starting in 2008 until 2017.

c. Continuing with this example, Roz returned to Israel on 1 January 2008, after being considered foreign resident from 2004-2007 inclusive.

Regarding employment where Roz was deemed foreign resident for only four years until returning to Israel in 2008, he will be entitled to the exemptions stated in paragraph 14(c) (1). Meaning, Roz will be tax exempt only on income from dividends for five years beginning in 2008 until 2012 inclusive.

d. Continuing with the example, Roz immigrates to Israel for the first time on 1 July 2008. According to paragraph 14(a) Roz will be tax exempt, while a new immigrant, from dividend & salary income generated from 1 July 2008 until 30 June 2018. Income from the second half of 2018 will be taxable.

e. Gil was deemed a new immigrant on 1 January 2008. Gil gives advice and offers technical support for the website he built. In 2008 there were 280 working days, of which he remained abroad 80 days, for work, and an additional 40 days for family holiday.

As per clarification d in paragraph 5.1.5 of the circular, the number of working days taken into account shall be 240 (280-40 days of vacation). A third of income generated from personal expenditure in 2008 shall be considered foreign generated income and will be tax exempt as per paragraph 14 of the ordinance.

f. Gila is considered a veteran returning resident from 1 January 2008. Gila is a professional Israeli model who is accustomed to remaining outside of Israel for periods not exceeding 60 working days as part of her job.

As per clarification d in paragraph 5.1.5 of the circular, Gila’s income generated abroad must be considered taxable in Israel as per the principle “secondary follows primary”.

g. Eyal is deemed a veteran returning resident from 1 January 2008. Eyal, a software engineer began working on 1 January 2013 for an Israeli software company. In 2013, Eyal was sent by his company to India for a

month for project development. Eyal's work in India was paid for by his company.

As per clarification e in paragraph 5.1.5 of the circular the income earned by Eyal while in India is taxable in Israel.

6. Profile of Residents

6.1 Profile 'A'

'A' is a systems engineer who completed his academic studies in 1998. Upon completion of his studies he began to work at an Israeli company involved in program development. In 2002 'A' resigned from his job in Israel and moved, with his girlfriend, to the USA. 'A' began to work at an American company in a field similar to that in which he worked in Israel. During his stay overseas, 'A' married his girlfriend and the couple saved the proceeds of the salary earned in the U.S. in varied methods including savings accounts, tradable bonds, and even invested in a private American company involved in developing a unique patent. During the year 2008, the couple returned home to Israel.

Directives of the law

In accordance with the amendment and in the framework of the temporary provision the couple will be considered "veteran returning residents" since in the year 2008 five consecutive years passed from the time they left Israel. The couple can submit a form to the Ministry of Absorption advising of their choice for a "year of adjustment", during which they will not be considered Israeli residents for taxation purposes, so that they will be able to reconsider their return to Israel during that year. After that year, and during the following 9 years, the couple will enjoy tax exemptions on their income generated from any type of income originating out of Israel. Similarly, if they sell their holdings in the American company in which they invested, they will enjoy a tax exemption for 10 years from the time of their return to Israel (the 10 years include the year of adjustment).

It is clear that if the couple returned to Israel during the years 2010 and 2011 they will not be regarded as "veteran returning residents" since the validity of the temporary provision, that determines the status of veteran returning resident for an individual who is considered foreign resident for 5 years and above, applies to one who returned to Israel during the years 2007 to 2009 only.

6.2 Profile 'B'

'A' is a surgeon who completed his academic studies in 1995.

During 2002, 'A' left Israel with his wife 'B' and moved to Spain. On arrival in Spain 'A' began to work in a hospital in Barcelona and to specialize with an expert in Ophthalmology. To complete specialization with this expert it was required that the resident work at the hospital for a period of 10 years from completion of the specialization. After 4 years of

specialization, 'A' continued to work in the hospital in Spain, and at the same time he opened a private clinic with a local doctor.

'B' established a private business. After 7 additional years during which the couple had two daughters, and after they had been in Spain for a total of 11 years, their longing for the State of Israel increased and they decided to return to Israel with their family. Since his obligatory period at the hospital was not completed, an agreement was reached whereby 'A' would continue to work at the hospital for 3 shifts per week which would be concentrated from Monday to Wednesday. 'A' similarly decided to continue to operate his clinic in Spain on these same days. 'A' and his family returned to Israel at the beginning of 2013 and from that time he was employed in a hospital in Israel as a specialist.

In 2015, 'B' sold her interest in the business she had established in Spain and with the proceeds she received, she established a similar business in Israel.

Directives of the law

In accordance with the amendment, in 2013 'A' and 'B' will be considered "veteran returning residents" since they stayed out of Israel for at least 10 years during which they were considered foreign residents. The couple can submit a form to the Ministry of Absorption advising of their choice for a year of adjustment, during which they will not be considered Israeli residents for taxation purposes, so that they will be able to reconsider their return to Israel and the absorption of their family (including getting the girls into the educational system) during that same year. After that year, and during the following 9 years, 'A' will enjoy tax exemptions from his salary that he will receive from the hospital in Spain for his work there from Mondays to Wednesdays, and also on his part of the profits of the private clinic in Spain for his days of work there. Similarly, and for the period of the exemption, 'A' will not be obligated to report in Israel on that income which is regarded as tax exempt. His salary income from his work in the hospital in Israel will be liable for full taxation in Israel. 'B' will enjoy tax exemption on the capital gains from the sale of her business in Spain; the income from the new business she established in Israel will be liable for full taxation.

6.3 Profile 'C'

From the time he was born, 'A' has lived in Brooklyn, New York. In 2008 upon reaching the age of 70, 'A' and his family decided to make Aliyah and to move their place of residence to Israel.

'A' is a successful lawyer with full ownership of a Bahamas based company which provides advisory services to residents of Canada and the USA; some of the advisory services actually given by 'A' are performed from Israel and some in the framework of his multiple trips overseas. 'A' receives a salary from the company for these advisory services. Included amongst 'A's other assets, is an apartment building in the USA, 20% share in a transportation company and a registered patent granted to an American company for an annual fee of \$1 million.

Directives of the law

In accordance with the existing amendment, 'A' and his family will be considered residents of Israel starting in 2008. The couple can submit a form to the Ministry of Absorption advising of their choice for a year of adjustment, during which they will not be considered Israeli residents for taxation purposes, so that they will be able to reconsider their aliyah to Israel during that same year. After that year, and during the following 9 years, 'A' will enjoy tax exemption for his salary that he will receive from the advisory services company, for that work which is performed out of Israel; such income is subject to reporting as specified in this circular and in accordance with the proportion of the number of business days that he stayed overseas for work purposes relative to the total number of workdays in that year (see paragraph 5.1.5 which deals with employment combinations).

Thus, he will enjoy a tax exemption from his income produced out of Israel, from rentals, dividends, capital gains, and income from royalties from the American company. According to the amendment, the regulations relating to a foreign trade company do not apply to the advisory company; therefore his share of the profits of the company will not be regarded as having been generated in Israel for they have not yet been produced in Israel. It must be stressed that according to the amendment and the period of the benefits, it is not determined that the foreign companies owned by 'A' are controlled and managed in Israel and they are therefore not considered Israeli resident companies.

During the period of exemption, 'A' is not obligated to report in Israel on his income from outside Israel that is tax exempt. 'A' will be taxed in full on income from investments and activities performed in Israel.

6.4 Profile D

'A' is a high tech promoter and invents specialized gadgets and during the last few years sold 2 start - up companies. In 2002 'A' decided to move to France. That same year she started a Cyprian company, under her sole ownership, and patented a new invention under that company.

After 7 years, in 2009, 'A' understood that the sale of the Cyprian company was delayed. In the meantime, her parents and brother in Israel asked her to return to Israel. 'A' decided to divide her life between France and Israel whereby one week a month she would continue to work for the company and the remaining time would be spent in Israel, where should would set up her new home.

Directives of the law

In accordance with the amendment as per temporary provision a she is considered a veteran returning resident, being that she remained abroad 5 consecutive years (as per the temporary provision for 2007-2009). A can submit a request for the year of adjustment from the absorption ministry, whereby she would not be deemed Israeli resident regarding tax, on condition that she is able to assay her return to Israel during that same year. Following this year, and for the next 9 additional years her foreign income generated from her work outside of Israel will be tax exempt. She

will be exempt from capital gains from the sale of her Cyprian company if done within 10 years of returning to Israel. In accordance with the amendment and the exemption period, the ordinance directive regarding a foreign controlled company will not apply to the Cyprian company. Indicated by the amendment, throughout the beneficiary period, the foreign company under her ownership will not be considered managed and governed in Israel and therefore, not Israeli resident. Likewise during the year of exemption, she is not subject to Israeli reporting on her income outside of Israel deemed tax exempt. All mixed activities and capital gains generated from Israeli business and companies she will found in Israel from the day of her immigration are fully taxable at the time of sale.