



The Israeli Tax Guide

Prepared for clients and prospective clients of
Anglo Capital Limited.



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The Israeli Tax Guide

A summary of Israeli tax information

The information in this book is based on our understanding of Israeli law, legislative proposals and current practice as at November 2008.

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.


Details apply to the tax years as stated in each particular section.

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

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Income Tax

Definitions

- **Residency in Israel**

Following the Income Tax Reform Law of 2003, the determination of an individual's place of residence is of paramount importance, as it is the basis on which an individual becomes liable for Israeli taxes on his worldwide income.

In a recent Directive from the Income Tax Authorities, it was indicated that the Israeli Tax Authorities will consider an individual as an Israeli resident if his centre of life is located in Israel (often referred to as the "Qualitative Test"). The centre of life is determined by a total overview of family, economic and social relationships of the individual. To this end, it is necessary to consider, inter alia, the location of his permanent home; his place of residence and that of family members; the place of occupation or employment (whether employee or self-employed); the location of the centre of his active and material economic interests; and the place of active involvement in organizations, associations or other institutions.

In addition, there is a "Qualitative Test" which could deem an individual's place of residence to be in Israel, if:

- He spent 183 days or more in Israel during the tax year, or
- He spent 30 days or more in Israel during the tax year and, together with the previous two tax years, spent 425 days or more in Israel.

This deeming provision of the Qualitative Test may be may be refuted by the individual concerned.

Proper review of both qualitative and quantitative factors is required in determination of residence.

Effective from September 2008, an individual ceases to be an Israeli resident only if:

- He stays out of Israel for 183 days or more during 2 consecutive tax years, and
- The centre of his life is outside of Israel for an additional 2 year period

- **New Resident / Oleh Chadash**

If one was never previously a resident of Israeli (Oleh Chadash), he may obtain benefits as defined for an Oleh Chadash / New Resident, as from the date of his first residency in Israel.

- **Prior Oleh Chadash**
 - An Oleh Chadash that arrived before 31st December 2006 would qualify for the Old Oleh Chadash Tax Exemptions.
- **New Oleh Chadash**
 - An Oleh Chadash that arrived after 1st January 2007 would qualify for the New Oleh Chadash Tax Exemptions.

The tax benefits granted to each category of Oleh Chadash will be detailed later in this Guide.

- **New Resident / Returning Resident**

If one was previously an Israeli resident, and now returns to live in Israel, he may be eligible for tax benefits.

The following are included in the pre-rulings of residency issued by the Israeli Tax Authorities, as tests to determine cessation and resumption of Israeli residency:

- residence in a "treaty" country where the person is considered "tax-resident,
- either owning a home in the foreign country or long-term rental (3 years or more) of home,
- Similarly no home owned in Israel or rented (i.e. sublet) for 3 years or more,
- The "taxpayer" did not spend more than 60 days, and his family more than 75 days, in Israel during each of the tax years,
- Payment of Bituach Leumi (In one case the person did not pay Bituach Leumi while resident outside the country, whilst in another, Bituach Leumi was paid as a foreign resident.

The status of a Returning Resident (Toshav Chozer) must first be determined:

- **Eligible - Long Absent Toshav Chozer**
 - Arrived between 1st January 2007 to 31st December 2009, and having been abroad > 5 years
 - Arrived after 1st January 2010, and having been abroad > 10 years
- **Eligible - Short Absent Toshav Chozer**
 - Arrived between 1st January 2007 to 31st December 2009, and having been abroad > 2 years and <5 years
 - Arrived after 1st January 2010, and having been abroad >4 years and <10 years
- **Prior Toshav Chozer**
 - Arrived before 31st December 2006, and having been abroad > 3 years (i.e. Toshav Chozer in terms of prior legislation.)

The tax benefits granted to each category of Toshav Chozer will be detailed later in this Guide.

Joint / Separate returns of married couple

It is important to note that in Israel the tax return relates to the family unit, and there is no separate tax return for each spouse. This means that all the income of both spouses is entered on one tax return each year. Despite this, some income is calculated based on separate tax rates for each spouse. Passive (unearned) income, such as bank interest, dividends, etc., is normally assessed as belonging to the spouse with the highest income and apart from certain exceptional circumstances, there is no separate assessment of that income for the other spouse. Earned income (including pensions) is, in most cases assessed separately, so that both spouses can benefit from the lower tax brackets and their own personal credits.

Personal Tax Rates

Personal Tax Rates for 2007 Tax Year

<u>Income Bands</u>	<u>Tax Rate</u>
From NIS 1 – NIS 51,240	10%
From NIS 51,241 - NIS 91,200	21%
From NIS 91,201 – NIS 136,920	29%
From NIS 136,921 – NIS 196,560	35%
From NIS 196,561 – NIS 423,240	36%
From NIS 423,241	48%

Personal Tax Rates for 2008 Tax Year

<u>Income Bands</u>	<u>Tax Rate</u>
From NIS 1 – NIS 52,680	10%
From NIS 52,681 - NIS 93,720	16%
From NIS 93,721 – NIS 140,640	26%
From NIS 140,641 – NIS 202,080	33%
From NIS 202,081 – NIS 435,120	35%
From NIS 435,121	47%

Taxation of Offshore Trusts

For a detailed explanation on this topic, please refer to the Anglo Capital Limited's "Guide to the Israeli Taxation of Offshore Trusts" which can be downloaded from Anglo Capital Limited's website – www.anglocapital.com.

Income Tax

Tax Credits and Credit Points

An Israeli resident taxpayer may reduce the amount of tax computed in accordance with the tax brackets and rates by using various allowable credits. Such credits are given, for example, in respect of residence in Israel, a non-working spouse, children of a working wife, new immigrant status, pension and life insurance costs and cost of travel to and from work.

Certain of these credits are given by means of credit points having a value fixed by law, while others are subject to specified ceiling amounts.

Non-residents are not entitled to most of the credits.

Exemption on Business Income earned by new resident

o **Prior Oleh Chadash**

An exemption has been granted to new 1st-time residents who continue to have income from a business, which they operated overseas for at least 5 years before becoming resident in Israel.

Exemption from Israeli income tax has been granted for 4 years from first arrival in Israel, in respect of income from the business (not director's fees from a company); if the new resident either continues to operate the business, or is simply entitled to receive income from that business. The exemption will be granted only if the business activity remains overseas and is not transferred to Israel.

o **New Oleh Chadash & Eligible - Long Absent Toshav Chozer**

An exemption on the reporting and liability to Israeli tax has been granted on overseas income not earned in Israel. This exemption is for a period of 10 years from assumption of Israeli residency.

The Israeli Tax Authorities have indicated that this exemption will not be granted if the income was earned overseas by the new resident due to his personal exertion from Israel. This could affect telecommuters and others working from Israel.

Israeli Residential Rental Income

An individual is exempt from income tax on rental income received from an Israeli residential property. This is subject to the condition that the monthly rental income does not exceed:

- 2004 – NIS 7,390
- 2005 – NIS 5,595
- 2006 – NIS 3,370
- 2007 – NIS 4,200.

The exemption applies only where the use of the property by the tenant is for residential purposes, and not for office or business purposes. As from January 2008, this income is exempt from Bituach Leumi.

Where the monthly rental from the properties exceeds these amounts, the exemption is reduced accordingly. The taxable income from rental is taxed at marginal personal tax rates.

Another alternative is to elect to be taxed at 10% of the gross rental income, with no deductions of expenses allowed. As from January 2008, this income is exempt from Bituach Leumi. To obtain this benefit, certain reporting requirements need to be adhered to.

Income Tax

CONTROLLED FOREIGN COMPANIES (CFC)

With the introduction of the tax reform in 2003, the Israeli Tax authorities have legislated provisions in the law to prevent Israeli taxpayers avoiding taxes by setting-up foreign corporations.

A Controlled Foreign Company (CFC) is defined as follows:-

- The company is not a publicly quoted company, or if partly quoted, the amount available to the public is less than 30% of the company's capital.
- The majority of the income of the CFC is passive income, or most of its profits accrue from passive income (this definition also attacks the setting-up of a string of companies).
- Tax is paid on the income of the CFC in a foreign country at an overall rate of less than 20%.
- More than 50% of the control of the company is in the hands of Israeli residents.

Passive income in this respect is defined as:

- Interest or linkage differences.
- Dividends.
- Royalties.
- Rent income.
- The proceeds of an asset, which was not used by the CFC for business or professional purposes.
- Any other income, which is sourced in any of the previous items, even if it may be considered as business or professional income.

Passive income does not include (earned) income from business or professional services, which in Israel would be considered as such, and taxed accordingly under Israeli tax law.

The above paragraphs are only a general outline of the situation, which, as has been mentioned above, are designed to prevent the avoidance of tax on income which would generally be taxable in Israel under the new reform. Tax is collected whereby the income of a CFC is treated as a dividend paid to the Israeli shareholder, pro-rata to his interest in the CFC, even if the dividend is not actually paid to him.

The residence of a company under Israeli tax law is determined, inter alia, on the basis of the "management and control" test. Under the September 2008 Amendment, foreign companies held by a **New Oleh Chadash** or **Eligible - Long Absent Toshav Chozer** will not be considered as "managed and controlled" from Israel, merely because of the immigration of their owner to Israel, for a period of 10 years from such immigration.

Capital Gains Tax

Overview

Capital Gains tax is payable on the real capital gains (excluding the inflationary element) earned by both companies and individual taxpayers. This would apply to assets owned by Israeli residents, wherever the asset is located worldwide.

Individuals will be taxed in accordance with the tax rates for individuals.

Inflationary capital gains are exempt from taxation. However, inflationary gains accumulated prior to 1st January 1994 are subject to a 10% capital gains tax.

Exemptions for New Residents & Returning Residents

o Prior Oleh Chadash; Eligible – Short Absent Toshav Chozer & Prior Toshav Chozer

In terms of the Israeli Tax Law, an exemption has been granted to new immigrants and returning residents on the sale of assets held by the taxpayer at the date of his arrival in Israel.

The period of this exemption is for ten years from the date of his arrival in Israel.

Disposals after the ten year exemption period will be liable to Israeli capital gains tax for the period beyond that time (on a proportional time basis), from the date of the original acquisition.

It is important to note that this exemption only applies to the specific asset held at the date of the taxpayer's arrival in Israel, and there is no roll-over relief provided for replacement assets. In other words, if the original asset is disposed of (capital gains tax free), the replacement asset purchased would not benefit from this exemption. The subsequent disposal of the replacement asset would be subject to Israeli capital gains tax. (This provision is very important for those tax payers who manage a stock portfolio, and might find themselves subject to capital gains taxes on the disposal of subsequent purchases.)

Notes:

- Please see chart below regarding Passive Income for details of benefits relating to specific capital gains tax categories.
- Some returning residents might have additional exemptions on interest, dividends and capital gains from a portfolio of traded securities, which are traded on a foreign stock exchange and managed within a specific bank account.

o New Oleh Chadash & Eligible - Long Absent Toshav Chozer

An exemption on the reporting and liability to Israeli tax has been granted on capital gains earned on overseas assets. This exemption is for a period of 10 years from assumption of Israeli residency.

Passive Income

Tax Rates on Passive Income received by Israeli residents

<u>Description of income</u>	<u>Source of income</u>	<u>Interest</u>	<u>Dividend</u>	<u>Capital Gain</u>	<u>Exemptions & Benefits for New / Returning Residents</u>
<u>Shekel deposit / savings plan – unlinked</u> • 2003 – 2005 • 2006 +	Israel	10% 15%			
<u>Shekel deposit / savings plan – indexed linked</u> • 2003 – 2005 • 2006 +	Israel	15% 20%			
<u>Foreign Currency Deposit</u> • 2003 – 2005 • 2006 +	Israel	15% 20%			<ul style="list-style-type: none"> • 20 year exemption for new immigrants • Non residents exempt
<u>Foreign Currency deposit</u> • 2003 – 2005 • 2006 +	Offshore	15% 20%			<ul style="list-style-type: none"> • 5 year exemption for: <ul style="list-style-type: none"> ➢ Prior Oleh Chadash ➢ Eligible –Short Absent Toshav Chozer ➢ Non – Eligible Toshav Chozer • 10 year exemption for: <ul style="list-style-type: none"> ➢ New Oleh Chadash ➢ Eligible –Long Absent Toshav Chozer
<u>Unquoted Shares</u> • 2003 – 2005 • 2006 +	Israel		25% 20%		
<u>Quoted Shares</u> • 2003 – 2005 • 2006 +	Israel		25% 20%	15% 20%	
<u>Quoted Shares</u> • 2003 – 2004 : Normal Israeli Resident “Individual Beneficiary” • 2005 • 2006 +	Offshore	35% 15% 15% 20%	35% 25% 25% 20%	35% 15% 15% 20%	<ul style="list-style-type: none"> • 5 year exemption on dividends for: <ul style="list-style-type: none"> ➢ Prior Oleh Chadash ➢ Eligible –Short Absent Toshav Chozer ➢ Prior Toshav Chozer
<u>Non Quoted Unit Trusts that are authorized by the Authorities in the country of issue</u> • 2003 - 2004: • 2005	Offshore	35% Marginal Personal	35% 25%	35% 25%	<ul style="list-style-type: none"> • 10 year exemption on capital gains for:

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.

<ul style="list-style-type: none"> • 2006 + 		Tax Rates 2005=49% 20%	20%	20%	<ul style="list-style-type: none"> ➤ Prior Oleh Chadash ➤ Eligible –Short Absent Toshav Chozer ➤ Prior Toshav Chozer Pro-rated if sale occurs after 10 years. (Previously 7 years, and limited to sale within the 7 year period.)
<u>Unquoted Shares or bonds</u> <ul style="list-style-type: none"> • 2003 – 2005 	Offshore	Marginal Personal Tax Rates 2005=49% 20%	25%	25%	
<ul style="list-style-type: none"> • 2006 + 		Marginal Personal Tax Rates 2005=49% 20%	20%	20%	

Exemption on Passive Income Earned by New Immigrants & Returning Residents

- **Prior Oleh Chadash, Eligible – Short Absent Toshav Chozer & Prior Toshav Chozer**

In terms of the 2003 tax reforms, special benefits for new immigrants/returning residents were instituted. In general, there is a 5 year exemption on passive income. This would include interest, dividends, royalties, rental income and pensions. The source of such income must be from assets held and accumulated outside of Israel and prior to taking up residence in Israel. As from January 2008, this income will be exempt from Bituach Leumi.

Note: Please see chart above for details of benefits relating to specific income categories.

- **New Oleh Chadash & Eligible - Long Absent Toshav Chozer**

An exemption on the reporting, and liability to Israeli tax has been granted on overseas income not earned in Israel. This exemption is for a period of 10 years from assumption of Israeli residency.

Interest received from Non Bank Loans & Non Traded Securities

Interest received from sources other than bank deposits, or from securities traded on a stock exchange (as per definition), will be taxed at regular income tax rates of 20% in line with other forms of passive income.

Exemption on Interest Income arising from deposits held in Israeli bank

An Oleh / New Resident is granted an exemption for a period of 20 years, on interest earned on deposits held in Israeli banks, on funds owned by the taxpayer before he became as Israeli resident.

This exemption is subject to the fulfillment of the following conditions:

- The funds are deposited in a foreign currency deposit, with an Israeli banking institution, for a fixed period, which is not shorter than 3 months.
- The funds are deposited within 90 days of their transfer to Israel.
- Within 14 days of opening the deposit, a declaration must be made to the bank as to when the taxpayer first became an Israeli resident.
- The interest income must be personal, and not part of ones business income. In addition, the bank is restricted from using these deposits as security for other loans.
- The exemption is valid for a period of 20 years from the taxpayer first becoming an Israeli resident.

A Toshav Chozer / Returning Resident will enjoy an exemption from tax on interest received on deposits held by an Israeli banking institution for a period of 5 years after his return to Israel, if the following conditions are fulfilled:

- The deposit in foreign currency arises from funds earned by the Toshav Chozer abroad during his period of non-residency in Israel, and on the condition that it did not arise from the sale of assets in Israel.
- These funds are deposited within 90 days of being transferred to Israel.
- Within 14 days of the deposit, the Toshav Chozer declares his status to the bank.
- The interest income is personal and not part of one's business income. In addition, the bank is restricted from using these deposits as security for other loans.

Overseas Rental Income

There are two alternative methods allowed to calculate the Israeli tax rate on overseas rental income earned on property owned by an Israeli resident. The taxpayer can choose either method.

1. If expenses incurred in the production of the rental income are claimed, then the net income after expenses will be taxed at regular normal tax rates (2005=49%). If foreign taxation has already been paid on this rental income, this will be allowed as a credit against the final tax payable in Israel.
2. A flat tax rate of 15% on the gross rental received, less depreciation. In this case, credit will not be allowed for foreign taxes paid. As from January 2008, this income will be exempt from Bituach Leumi.

How does one receive these tax benefits?

If an Oleh Chadash/ Toshav Chozer received income/ capital gains from abroad, he is required to submit an annual tax return and request the relevant exemption/ tax reductions appropriate to his circumstances, unless he is exempt from submitting a tax return.

Tip

Due to the complexity of these matters, it is advisable to get a professional Israeli tax advisor/ accountant to prepare these tax returns and submit them on one's behalf.

Pensions

Israeli tax treatment of pensions

- Regular personal tax rates will apply in Israel on 65% of the pension (after allowing for the statutory 35% exemption).
- The Israeli Bituach Leumi / National Insurance pension is exempt from Israeli Income tax.
- The taxable element of a pension received by a person under the Israeli retirement age will also be subject to Bituach Leumi (from January 2008 the effective rate is 12%)

Israeli tax treatment of overseas pensions

- The 5-year exemption on passive income mentioned above for **Prior Olim Chadashim, Eligible – Short Absent Toshavim Chozrim & Eligible Toshavim Chozrim**, and 10 year exemption on passive income mentioned above for **New Olim Chadashim & Eligible – Long Absent Toshavim Chozrim** also applies to overseas pensions received by them. As from January 2008, this exempt income will also be exempt from Bituach Leumi.
- After the initial 5 or 10 year exemption period (as applicable), the Israeli tax law states that the tax to be paid on pensions will be no more than the tax which would have been paid in the country of origin. If this limitation applies, the Israeli tax authorities will require supportive documentation. (This section applies only to New Residents, Eligible – Long Absent Returning Residents as well as Israeli-born returning juveniles, but not other Returning Residents.)
- The main conditions to determine whether income is defined as overseas pension are:-
 - The pension is receivable at regular intervals.
 - The pension arises from regular deposits into a pension fund which were made while working overseas as an employee or self-employed person out of that income source.
 - If deposits were made by the pensioner, as an employee, any sums deposited by the employer are included as well.

(The above definition only covers a pension received in respect of work performed in a foreign country. **This means that there is a question as to whether a private overseas pension funded by the taxpayer will be included in this category.)**

- The Israeli Tax Authorities are considering simplifying the procedures regarding the taxation of overseas pensions, which have proved to be unduly cumbersome to administer.

Information Highlight

Due to the complexity of the differing nature of different worldwide pension arrangements, there is uncertainty as to how the Israeli Tax Authorities will tax overseas pensions received by Israeli residents.

Each person is advised to obtain specific professional advice regarding this matter, in particular those Olim immigrating to Israel, in possession of overseas pensions. It is advisable that this advice is obtained before aliya is made.

Note for emigrants from the US

The U.S Social Security Pension is tax exempt under the Double Tax Treaty between the two countries. This compares to 85% of the Social Security pension being taxable for US residents.

Inheritance Tax

There is currently no inheritance tax or estate duty imposed by the Israeli tax authorities on the estates of deceased Israeli residents.

Information Highlight

There is a "tax trap" in the Israeli tax legislation, regarding the capital gains tax liability on the sale of assets that an Israeli resident inherits from overseas.

Israeli residents that have expectations of receiving inheritances from overseas, are advised to obtain professional opinion as how these inheritances may be structured from an Israeli tax perspective, to be tax efficient once the inheritance has been received by the Israeli resident.

Value Added Tax [VAT]

The VAT law is a modern law with elements that are similar to laws in place in the European community. The law mainly provides that tax be levied on the value added element of services and goods sold in the market.

VAT is imposed on every stage of economic performance starting with raw materials and culminating in the finished product as purchased by the consumer or end-user.

VAT applies to every transaction made in the buyer-seller chain, and is paid in respect of the value added at every stage to a specific product. The tax incorporated in the expenses incurred by the transactor is deducted from the tax imposed on the transaction at that stage.

Typically the price appearing on a product or regarding a service already includes the VAT imposed on their sale. If a person carrying out the transaction wishes to quote prices net of VAT, he must explicitly state that such prices do not include VAT.

In general, anyone running a business in Israel must register as a "VAT dealer" for the purposes of the VAT law.

The current VAT rate is 15.5%.

National Insurance – Bituach Leumi

A number of important changes were made to the Bituach Leumi (National Insurance), which took effect at the beginning of 2008.

- National Insurance contributions for Israeli residents are payable at rates ranging up to: employers, 5.43 percent; employees, 12.00%; self-employed, 16.23%; and non-employment income, 16.05%. The upper income limit for National Insurance payments has been raised from NIS 35,760 to NIS 36,760 per month.
- 52% of National Insurance contributions paid in a tax year on self-employment and non-employment income are deductible for income tax purposes in that year.
- Israel has entered into social security "totalization agreements" with Austria, Belgium, Canada, Czech Republic, Denmark, Finland, France, Germany, Italy, the Netherlands, Poland, Sweden, Switzerland, the UK and Uruguay. Such an agreement has not been entered into with the US.
- If you enjoy passive income as well as income from other sources, the passive income may now be subject to National Insurance payments. Previously, this was not the case if the passive income was less than 50% of total income.
- Certain exemptions to National Insurance payments will now be available to individuals if certain conditions are met.
 - Passive income not exceeding 25% of the national average salary (approximately NIS 22,500 per year) will not be subject to National Insurance contributions.
 - Dividend income will now be exempt from National Insurance payments unless the company is a "family company" or a "house property company", where the shareholders are taxed on their income instead of the company. Commencing in 2008, the income of these companies will be distributed to the shareholders as a dividend at the end of each year and subject to National Insurance payments accordingly.

- o Interest and discount income will be exempt from National Insurance payments, except in the following cases:
 - the income is business income for the recipient; borrowing costs are claimed as an expense;
 - the recipient is a "material shareholder";
 - the recipient is an employee of the company or supplier of goods or services to it or is related to it unless the interest is on arm's length terms.
- o Rental income will be exempt if you elect to pay tax on gross income (instead of net income) at the rate of 10% in the case of Israeli residential rental income, or 15% in the case of foreign rental income (after deducting depreciation) of any type. If you elect to pay full Israeli taxes (up to 47% in 2008) on net income, after deducting borrowing and other costs, or claim a foreign tax credit, you will also be liable to pay National Insurance too.
- o Passive income will be exempt from National Insurance payments if it is exempt from income tax (except early pension income). This exemption includes
 - New and Returning Residents who enjoy an exemption for passive income from investments they held abroad before they took up Israeli residence;
 - Israeli residential rental income not exceeding NIS 4,320 (in 2008) per month;
 - foreign currency exchange gains.

Further information can be obtained from the NII's website:

http://www.btl.gov.il/English/eng_index.asp

Information Highlight

Mas Briut : Health Tax

Mas Briut must be paid by all Israeli residents.

Normally this is included on an employees salary slip.

If one is not working, after the initial exemption period of six months after aliya, an Israeli resident must register and pay the Mas Briut.

This is over-and-above the payments to one's Kupat Cholim (health fund). Non payment can cause eventual payment of accumulated amounts, plus potential interest & fines.

Double Taxation Relief

Israel has signed comprehensive bilateral treaties for the avoidance of double taxation with most of its principal trading partners, based on the model recommended by the Organization for Economic Cooperation and Development (OECD). These treaties restrict the right of their signatories to tax income from particular sources and oblige the country of a taxpayer's residence to credit him for taxes paid in the country where income arose.

Partial list of countries that have entered into Double Tax Agreements with Israel:

- Belgium
- Canada
- France
- Germany
- Hungary
- Ireland
- Japan
- Netherlands
- South Africa
- United Kingdom
- United States

Tip

Due to the complexity of these matters, it is advisable to get specific professional Israeli tax opinion on any matter relating to the workings of these Double Tax Treaties.



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