Deloitte.

International tax

Israel Highlights 2014

Investment basics:

Currency – New Israeli Shekel (NIS)

Foreign exchange control – There are no foreign currency restrictions.

Accounting principles/financial statements – Accepted accounting principles according to Israeli accounting standards board/IFRS. Financial statements must be prepared annually (quarterly in the case of a public company).

Principal business entities – These are the public and private limited liability company, partnership (registered and nonregistered) and branch of a foreign corporation.

Corporate taxation:

Residence – A corporation is deemed to be resident in Israel if its activities are managed and controlled from Israel or if it is organized under the laws of Israel.

A foreign corporation managed and controlled by a new Israeli resident or a senior returning resident (i.e. an individual who spent 10 years abroad) generally will not be classified as an Israeli resident company for a benefited period of 10 years.

Basis – Israeli resident companies are subject to tax on worldwide profits and gains, with credit granted for overseas taxes. A nonresident company is subject to tax only on Israeli-source profits, which include, *inter alia*, income deriving from an Israeli permanent establishment (PE) or income accrued and produced in Israel, as well as capital gains from the sale of Israeli assets.

Taxable income – For an Israeli resident corporation, corporate income tax applies to all income, regardless of where it arises from. Israeli-resident companies are subject to capital gains tax on their worldwide capital gains.

Taxation of dividends – The tax rate on dividends distributed by an Israeli resident company to another Israeli company is 0%, provided the dividends arise from income produced or accrued in Israel. The tax rate on dividends from income produced (or accrued) abroad, or from dividends received from abroad, is 25%; a tax credit will be granted for tax withheld. Alternatively, the gross dividend will be subject to the regular corporate tax rate, with both a direct and an indirect foreign tax credit, if the Israeli company qualifies for the indirect tax credit mechanism.

Dividends distributed by a "preferred enterprise" as from 1 January 2014 are taxed at a 20% rate. Dividends distributed by an “approved/benefited enterprise” generally are taxed at a 15% rate if the distribution is made from profits attributable to the approved/benefited enterprise, or at a reduced rate of 4% on the alternative incentive track (“Ireland Track”).

Dividends distributed from a revaluation of assets will be taxed as a sale of the assets, and thus will be subject to capital gains tax, which will be levied on the difference between the original purchase price of the asset and the gross amount distributed.

Capital gains – The capital gains tax rate depends on the purchase date and the nature of the asset. The general capital gains tax rate for a corporation is the standard corporate tax rate. The inflationary component of the gain (accrued as from 1 January 1994) is exempt from tax.

An Israeli resident is subject to capital gains tax in Israel on the disposal of its assets, regardless of whether the assets are located in Israel. Capital gains derived from the sale, exchange, transfer or other disposition of tangible and intangible capital assets located in Israel or constituting a direct or indirect ownership interest of assets in Israel, are treated as Israeli-source income and are subject to Israeli capital gains tax, regardless of whether the seller is a resident of Israel for Israeli tax purposes. Shares and other securities of Israeli companies, or shares and other securities of non-Israeli companies holding their main assets in Israel, also may be treated as Israeli assets.

Persons who are not residents of Israel for tax purposes are exempt from Israeli capital gains tax on gains from the sale of shares traded on the Tel Aviv stock exchange and gains from the sale of shares of Israeli companies traded on stock exchanges overseas acquired after listing, unless the gain is attributable to a PE the seller maintains in Israel. Nonresidents also are exempt from tax on gains derived from the sale of shares allocated to them by an Israeli-resident company in consideration for their capital investment, provided the allocating company was qualified, at the time of the allocation, as a "Research and Development Intensive Company".

A broad exemption from capital gains tax applies to gains derived from the sale of securities in Israeli or Israeli-related companies acquired on or after 1 January 2009 by all nonresidents (both entities and individuals), regardless of whether the nonresident is eligible for tax treaty benefits. This exemption is subject to several restrictions. The exemption does not apply (1) to shares of companies whose assets consist primarily (directly or indirectly) of real estate (i.e. land or buildings); (2) if the shares sold were purchased from a related party or by way of certain tax-deferred reorganizations; (3) if the shares were held through a PE; or (4) when the nonresident selling entity is 25% or more controlled by Israeli residents.

Losses – Trading or business losses may be offset against income from any source in the same year. Losses may be carried forward indefinitely to be offset against business income and business capital gains. Losses may not be carried back.

Rate – The basic tax rate for companies is 26.5% as from 1 January 2014. Israeli companies classified as preferred enterprises are taxed depending on the location of their plant (9% if located in Area A; 16% if located elsewhere).

Israeli companies classified as approved or benefited enterprises are entitled to reduced tax rates (0%-25%), with the period of benefits depending on the location of the plant (Area A or elsewhere) and whether certain conditions are satisfied. The benefits will be revoked if profits deriving from the benefited income are distributed.

Qualified companies may be eligible for both reduced corporate tax rates and grants from the Investment Center.

There are no basic differences in the tax regime as applied to different forms of business organizations. However, partnerships are transparent for tax purposes.

Surtax – No

Alternative minimum tax – No

Foreign tax credit – Israel grants a direct foreign tax credit on foreign taxes paid on non-Israeli-source income. An indirect tax credit is granted in certain cases.

Participation exemption – A special tax regime applies to Israeli holding companies that invest in foreign corporations. Eligible corporations are entitled to an exemption from tax on dividends received from qualified foreign subsidiaries and on capital gains derived from the sale of shares in such foreign subsidiaries, as well as a full exemption from tax on financial income derived from investments in the Israeli capital market. In addition, dividends paid by the holding company to nonresident shareholders are subject to a 5% withholding tax, rather than the normal 25% rate.

Holding company regime – See under "Participation exemption."

Incentives – Various programs are available, e.g. foreign investment incentives (approved enterprise status, various tracks), a holding company regime and R&D incentives. See also "Taxation of dividends" and "Rate," above.

Withholding tax:

Dividends – Dividends paid to a noncontrolling foreign resident (i.e. one that holds less than 10% of the shares of the Israeli payer) are subject to a 25% withholding tax; otherwise, the rate is 30%. These rates may be reduced under a tax treaty or incentives regime.

Dividends paid to a resident individual are subject to a 25% withholding tax, although individuals classified as "significant shareholders" (that hold more than 10% in one of the means of controlling the company) are subject to a 30% withholding tax rate.

Dividends distributed by a preferred enterprise as from 1 January 2014 are taxed at a 20% rate. Dividends distributed by an approved/benefited enterprise generally are taxed at a 15% rate if the distribution is made from profits attributable to the approved enterprise, or at a reduced rate of 4% on the alternative incentive track ("Ireland Track").

Interest – A 15% or 25% withholding tax is levied depending, *inter alia*, on the type of loan (whether or not linked to the index) and whether the recipient of the interest is an individual or a "body of persons." These rates may be reduced under a tax treaty. A 0% withholding tax may apply to nonresidents who receive interest from bonds that are publicly traded on the Israeli stock exchange.

Royalties – A 25% withholding tax is levied on royalty payments to nonresidents. The rate may be reduced under a tax treaty.

Technical service fees – See "Other," below.

Branch remittance tax – There is no specific tax on the remittance of profits; however, in the case of an approved enterprise, a branch may be subject to a tax rate of 15%, in addition to the corporate income tax.

Other – Other payments to non-Israeli corporations are subject to withholding tax at a rate of 25%. The rate may be reduced under a tax treaty.

Other taxes on corporations:

Capital duty – No

Payroll tax – Payroll tax is levied only on nonprofit organizations (at a rate of 7.5% of wages) and financial institutions (at a rate of 18% of wages).

Real property tax – "Property Betterment Tax" is applicable to the sale of real property. The principles of the property betterment tax are similar to those of the capital gains tax. The betterment is calculated from the date of purchase until the date of sale, and the amount of betterment is subject to the corporate tax rate at the date of sale.

Furthermore, in certain circumstances (especially when real property is sold), the municipal authorities may levy a "betterment levy" at the rate of 50% on the betterment that the real property has gained as a result of the local municipal authorities' actions. Any betterment levy paid may be deducted from the betterment subject to property betterment tax.

Social security – National insurance is required by law (covering allowances and stipends). Some employers pay part or all of employees' compulsory contributions to the national insurance scheme.

Stamp duty – No

Transfer tax – See under "Real property tax."

Other – The purchaser of real property is subject to purchase tax (acquisition tax) of 6%. When the asset purchased is a residential apartment, the purchaser is subject to purchase tax at progressive rates ranging from 0%-10%.

A purchase tax (also applicable to individuals) also is levied on certain imports or local industrial production and is collected from local manufacturers 15 days after the end of the month in which the goods are sold. Importers are required to submit the collected tax when the goods are released from customs.

Anti-avoidance rules:

Transfer pricing – The transfer pricing rules, based on the OECD guidelines, apply to transactions between an Israeli resident and its related nonresident. A hierarchy of transfer pricing methodologies applies, with preference given to transaction-based methods over profit-based methods. Documentation requirements mandate that the taxpayer attach a statement to the annual tax return and provide a detailed transfer pricing study at the request of the tax authorities. Advance pricing agreements may be obtained.

Thin capitalization – No

Controlled foreign companies – A foreign company "controlled" by Israeli shareholders which has accumulated undistributed passive profits taxed at a rate lower than 15% (20% prior to 1 January 2014) will be considered a CFC. In such a case, the Israelis controlling the CFC will be treated as if they had received their proportionate share of the profits as dividends (deemed dividends). Upon the distribution of profits, the Israeli controlling shareholders will be eligible for a deduction in the amount of the gross notional dividends that were subject to Israeli tax (however, the deduction will not exceed the amount of profits being distributed), in addition to a tax credit for foreign tax.

Other – Artificial transactions may be challenged.

Disclosure requirements – The taxpayer generally must disclose all facts relevant for taxation, especially with respect to transactions with related parties.

Administration and compliance:

Tax year – The tax year begins in January. Taxpayers may apply for a different tax year, but the application will be approved only in special circumstances.

Consolidated returns – The filing of a consolidated return generally is not permitted in Israel; each company in a group is required to file its own return. However, if certain conditions are satisfied, qualified "industrial companies" may file a consolidated tax return.

Filing requirements – Companies must file an annual tax return no later than five months following the end of the tax year (an extension to file may be obtained in certain circumstances). The tax authorities determine advance tax payments, with some taxpayers required to pay tax according to their monthly turnover.

Penalties – Penalties apply if advance payments are overdue or if tax returns are filed late. The balance of any tax due is payable as of the beginning of the following tax year. Any overdue tax is subject to an annual 4% interest rate (both the interest and principal are linked to the Consumer Price Index (CPI)) until paid in full.

Rulings – A taxpayer may request a ruling on the tax consequences of a proposed transaction.

Personal taxation:

Basis – Israeli residents are taxed on their worldwide income. Nonresidents are taxed only on Israeli-source income.

Residence – An individual is resident in Israel if his/her "center of vital interests" is in Israel. The number of days spent in Israel and overseas also affects residence status: an individual will be deemed to be resident if he/she spent 183 days or more in Israel, or if during the current tax year he/she spends 30 days or more in Israel and the total duration of his/her stay in Israel in the tax year and in the two preceding tax years, on a cumulative basis, amounts to 425 days or more.

An Israeli resident who spends two consecutive years abroad (183 days each year) and whose center of vital interests in the two subsequent years was located abroad will be deemed to be a foreign resident as from the date the individual chose to leave Israel.

Filing status – A married couple, living together, may opt for separate tax assessment in certain circumstances.

Taxable income – All income from employment and business is taxable, including the value of fringe benefits and cost-of-living allowances. Passive income from bank deposits and savings, both in Israel and overseas, also is taxable.

New Israeli residents and senior returning residents are entitled to a tax exemption for certain types of foreign-source income for a period of 10 years as from the date of immigration/return to Israel. The benefit period may be extended for a maximum of an additional 10-year period, provided that certain investment criteria are fulfilled and approval is obtained from the Minister of Finance.

Capital gains – "Real" gains (i.e. the portion of gains not derived from inflation) derived from the sale of shares in publicly traded companies are subject to a 25% tax rate if derived by noncontrolling shareholders (i.e. those holding less than 10% of the Israeli payer company's shares); otherwise the rate is 30%. Gains deriving from the sale of bonds, commercial securities or loans that are not linked to the CPI generally are subject to a 15% tax (however, a controlling shareholder that holds more than 10% of the Israeli payer company's shares will be taxed on both the real and the inflationary component of gains at 20%).

The rates for capital gains on all other assets range from 20% up to the individual's marginal tax rate, depending on the date of acquisition and the type of asset (the minimum tax rate for the sale of shares of nonpublicly traded companies by an individual holding more than 10% of the company's shares is 25%).

The inflationary component of gains accrued as from 1 January 1994 is exempt from tax (except as noted above).

Regarding exemptions from capital gains please see "Capital gains" under "Corporate taxation," above.

Deductions and allowances – Deductions are granted for pension fund contributions, and individuals are entitled to various personal allowances and credits.

Rates – The income tax rates are progressive up to 50% (increased from 48%; however, the Ministry of Finance has stated it is likely to change the highest personal marginal tax rate back to 48%).

An additional 2% surtax is levied on the annual taxable income exceeding approximately NIS 825,055. The additional tax is not applicable to certain types of income.

Other taxes on individuals:

Capital duty – No

Stamp duty – No

Capital acquisitions tax – No

Real property tax – "Property Betterment Tax" is applicable to the sale of real property. The principles of the property betterment tax are similar to those of the capital gains tax. The tax regime uses a linear tax model that taxes the real betterment at different tax rates, depending on dates on which the betterment was accrued. Betterment accrued from the date of purchase up to 7 November 2001 is subject to the marginal individual tax rates; betterment accrued from 8 November 2001 up to 1 January 2012 is subject to the marginal individual tax rates up to 20%; and betterment accrued after 1 January 2012 is subject to the marginal individual tax rates up to 25% (30% if the seller holds more than 10% of a real estate company).

If the asset is a residential apartment, all real betterment accrued before 1 January 1 2014 is exempt, and all subsequent betterment is subject to the marginal individual tax rates up to 25% (30% if the seller holds more than 10% of a real estate company).

A purchaser of real property is subject to purchase tax (acquisition tax) of 6%. When the asset purchased is a residential apartment, the purchaser is subject to purchase tax at progressive rates ranging from 0%-10%.

Furthermore, in certain circumstances (especially when real property is sold), the municipal authorities may levy a "betterment levy" at the rate of 50% on the betterment that the real property has gained as a result of the local municipal authorities' actions. Any betterment levy paid may be deducted from the betterment subject to property betterment tax.

Inheritance/estate tax – No

Net wealth/net worth tax – No

Social security – National insurance is required by law (covering allowances and stipends for pensioners, widow/ers, disability, maternity, children's allowances, industrial accidents, military service pay and unemployment). Some employers pay part or all of workers' compulsory contributions to the national insurance scheme.

In addition, every individual is subject to Health Care Tax.

Administration and compliance:

Tax year – Calendar year

Filing and payment – Individuals must file an annual tax return no later than 30 April of the following year (an extension of time to file may be obtained in certain circumstances). Certain filing exemptions are granted for qualifying taxpayers.

A new Israeli resident or a senior returning resident will not be subject to the reporting requirements in Israel on income derived from or accrued outside Israel, or sourced from assets outside Israel for the 10-year benefited period.

Penalties – Penalties apply if advance payments are overdue or if tax returns are filed late. The balance of any tax due is payable as of the beginning of the following tax year. Any overdue tax is subject to an annual 4% interest rate (both the interest and principal are linked to the CPI) until paid in full.

Value added tax:

Taxable transactions – VAT applies to most goods and services, including imported goods and services.

Rates – The standard VAT rate is 18%. Certain items are subject to a 0% rate, including exported goods, intangible goods and the provision of certain services to nonresidents (i.e. tourism services), the transport of cargo to and from Israel, the sale of goods and services to the Eilat free-trade zone and the sale of fresh fruit and vegetables.

Payroll tax, which is levied on nonprofit organizations at a rate of 7.5% of wages and on financial institutions at the rate of 18% of wages, is imposed in lieu of the VAT for these types of entities.

Registration – An Israeli company generally must register for VAT purposes. A foreign company registered in Israel or a nonregistered foreign company that carries on an activity or business in Israel must appoint a local representative for VAT purposes within 30 days of commencing its domestic activities, and must notify the VAT office closest to its place of business.

Filing and payment – The dealer will collect output VAT on the goods, services or assets it sells. The VAT collected will be transferred to the VAT authorities once a month or once every two months, whichever is determined to be more appropriate by the authorities based on the annual turnover projection (once a month if the annual turnover is greater than approximately NIS 1,500,000). The dealer may offset the output VAT against any input VAT paid in the course of doing business.

The annual revenue threshold to qualify as an "exempt dealer" under the VAT law is approximately NIS 80,000. Such dealers are exempt from output VAT and receive relief from filing periodic VAT returns (other than the annual declaration reporting the annual turnover). Exempt dealers are not entitled to recover their input VAT.

Source of tax law: Income Tax Ordinance 1961 and accompanying regulations

Tax treaties: Israel has more than 50 tax treaties.

Tax authorities: Ministry of Finance, Israel Tax Authority

International organizations: WTO

Deloitte contact
Yitzchak Chikorel
E-mail: ychikorel@deloitte.com