

# THE ISRAELI TAX SYSTEM

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## Introduction





**Stark & Stark**

## Living with the Israeli tax system

An opportunity to learn about Israel's tax requirements and maximizing your benefits:

- ❖ Israeli residency for tax purposes
- ❖ Maximize your Oleh benefits and avoid tax traps
- ❖ What happens after 10 year tax holiday?
- ❖ How are Israeli investments taxed?
- ❖ Working with Israeli banks
- ❖ Does your estate plan work in Israel?
- ❖ Impact of Israeli trust law on your foreign trusts
- ❖ Staying compliant in the US
- ❖ Tax credits for charitable donations
- ❖ Social Security
- ❖ Voluntary disclosure in Israel

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# The Israeli tax system



Taxation in Israel is based on the Individual and Territorial Methods. According to the Individual Method, since 2003, all Israeli residents are liable for payment of tax in respect of their entire worldwide income.

	Income derived from Israel	Income derived from abroad	Notes
Foreign Resident			According to the Territorial Method.
Israeli Resident			According to the Individual & Territorial Methods.

## TREATY RELIEFS

Israel is a signatory to the Treaty for the Prevention of Double Taxation with about 50 countries worldwide. Most of Israel's tax treaties are based on the Model Tax Convention of the OECD (the Organization for Economic Cooperation and Development). The countries that have tax treaties with Israel include (among others) the United Kingdom, the United States, Singapore, Austria, France, Denmark, India and Poland.



## **TAX RATES (CURRENTLY) - 2016**

	<b>Corporate Tax</b>	<b>Individual Tax</b> According annual calculation	<b>Withholding tax on payments to foreign resident</b>	<b>VAT</b>
<b>Income tax</b>	25%	Up to 48%	30% unless reduced under an applicable tax treaty. Referred to active and passive income.	17%
		Additional 2% From 1.1.2013 over \$200,000		
<b>Capital Gains tax</b>	25%	25% / 30%(**)		
<b>Dividend</b>	0% / 25%(*)	25% / 30%(**)		



(\*) upon distribution to a non-Israeli company or on dividend distribution from non-Israeli company.

(\*\*) in case an individual holds 10% or more, of any means of control of a company.

(\*\*\*) There is a draft bill to tax owner of a 'Wallet Company' that if half of the company income came from one source. Under the proposal, the tax authorities will see the company income as the income of the owner, even if the money will remain in the company, and he will have to pay tax on that income.

**There is no inheritance tax in Israel.**

## The individual tax (in NIS) – Tax Brackets - 2016

Annual Wage	Marginal Tax Rate	Tax In Practice	Accumulated Tax
62,640	10%	6,264	6,264
107,040	14%	,6216	,12480
166,320	21%	12,449	24,929
237,600	31%	22,097	47,026
496,920	34%	88,169	135,195
803,520	48%	147,168	282,363
Any additional NIS	50%	-	-



## Social Security

Aside from the tax obligation, each Israeli resident from the age of 18 until retirement must pay for social security and health care. The amount is derived from the monthly income in accordance with the following brackets (updated as of 01/2016):

### For Employees:

	Monthly income up to NIS 5,678			Monthly income from NIS 5,678 to NIS 43,240		
	The Employer	The Employee	Total	The Employer	The Employee	Total
Social Security payment	3.45 %	0.40 %	3.85 %	7.50 %	7.00 %	14.50 %
Health care payment	-	3.10 %	3.10 %	-	5.00 %	5.00 %
Total	3.45 %	3.50 %	6.95 %	7.50 %	12.00 %	19.50 %

# Social Security

## For Self Employed



	Monthly income up to NIS 5,678	Monthly income from NIS 5,678 to NIS 43,240
Social Security payment	6.72 %	11.23 %
Health care payment	3.10 %	5.00 %
Total	9.82 %	16.23 %

Israel does not have a Social Security treaty with U.S. Therefore, a U.S citizen who is considered in Israel as resident will be taxed twice.

# So who's an Israeli resident?



## Residency Test:

Corporations - The “Management and Control” test or the country of registration.

Individuals - The “center of life” test.

Indicators which might be crucial for the individual’s “center of life” test:

- During the tax year, the individual spent 183 or more days in Israel;
  - The location of his permanent home;
  - His and his family's location of residence;
  - His regular or permanent place of business or the place of his permanent employment;
  - The location of his active and substantive economic interests;
  - The location of his activity in organizations, societies and various institutions.
- A new amendment from 01/2016 declares that an individual who believes he’s not a resident but spent over 183 days in Israel must submit a report with legitimate evidence regarding his non-resident status.

## From the latest court ruling

- Verdict from 15/06/2016 – An Israeli citizen who has spent his time by playing poker around the world since 2002 was required to pay the applicable tax for his winnings during 2007.
- Despite the fact that this taxpayer spent only 30 days in Israel during 2007, he didn't manage to prove that he has permanent residency outside of Israel.

The following is a list of his time spent in each country during the tax year 2007:

Israel – 30 days

England – 30 days

Australia – 2.5 months

U.S – 7.5 months



# Apartment Taxation in Israel - For Israel & Foreign Investors

## Individuals:

Residential rental income (3 optional applicable tracks, according the individual choice):	<u>Limit</u>
1. Residential rental income is taxable at 10% of gross income. This track does not enable deduction of any kind of expense.	No limitation as long the activity not considered a business
2. Exemption on gross income from residential rental. This track does not enable deduction of any kind of expense.	Up to NIS 5,030 per month (\$15,600 per year)
3. Taxation according the standard tax brackets, starts at 31% bracket. One may deduct building improvement and current expenses from the revenue, including depreciation and financing costs.	-



(\*) Today, there is a bill to tax owners of three or more residential apartments. The tax will be 1% of the value of each residential apartment up to a maximum amount of NIS 1,500 per month (\$ 4,700 per year ,per apartment). The tax will not be imposed on the two first apartments.

## Residential Betterment Tax – for Israeli & foreign residents

Each residential apartment which was acquired from 2014 onward will be taxed at a rate of 25% of the profit.

Regarding sole apartment – if it's the only apartment owned by the individual, there is a tax exemption of up to NIS 4,456,000.

Any excess amount will be taxed at the 25% rate.



## New immigrant:



- **“New Immigrant”** (Oleh Hadash) is an individual who has never been a resident of Israel in the past and became an Israeli resident for the first time. The question of Israeli residence is examined by the usual tests that were established in the Income Tax Ordinance (“center of life”).
- **Adjustment Year** - An individual who became an Israeli resident for the first time shall not be deemed an Israeli resident for a duration of one year from the date on which he arrived in Israel as long he announced within ninety days of his arrival.
- **Tax Benefit** – New Immigrant that owns a foreign company that is active and managed by him, might considered as an Israeli resident given the fact that the owner is an Israeli resident. Therefore, it has decided by the tax authorities that in order to incentive “Olim Hadashim”, a foreign company will not be considered as an Israeli resident according the “management and control test” just because of the individual immigration which owns it. That applies as long as the company’s income doesn't derive in Israel.

## Oleh Hadash's benefits



Income produced outside Israel	During the first 10 years	After 10 years	Notes
Active	Tax Free	Taxable	As long the income doesn't have any connection to Israel
Passive	Tax Free	The profit which was earned after the 10- year exemption is taxable.	

## Step Up – The day after the 10 years exemption

Selling an asset (real estate, securities, etc.) that is not related to Israel after the 10-year exemption for new immigrants-

- In order to not lose the exemption regarding the income accrued during the exemption period, there is a mechanism that splits the income for the exemption period and for the taxable period (Step Up Mechanism).
- To qualify for the exemption, an Oleh Hadash should contact the tax authorities at the end of the exemption period or after selling the asset. Even if an asset is sold after the exemption period expires, the exempt period will be taken into account as a proportion of the entire holding period of the asset.
- If there is documentation that supports the market value of the asset at the end of the exemption period, the tax calculation can be based on the value of the asset at the end of the exemption period.



## Tax resolutions

- **Tax resolution 253/12 (2012)** – an income of an employee who works in Israel for a foreign company/organization which has no affiliation with Israel is taxable in Israel.
- The employee creates a permanent establishment for the company in Israel.

## Charity



Endowment to Public Institution*	Individual	Company	Limits	Amounts beyond credit limitation
Tax credit on the endowment amount	35%	Corporation tax rate	Up to 30%** of the taxpayer's taxable income or NIS 9,212,000.	Shall be credited against tax in accordance the following 3 years.

\*"public institution" –a body of at least seven persons most of whom are not related to each other, or an endowment, most of the trustees of which are not related to each other, which exists and functions for a public purpose, its property and income being only used for the public purpose, and which submits annual reports on its assets, income and expenses according to regulations made for this purpose by the Minister of Finance.

\*\* The U.S-ISRAEL treaty states that endowments which were given in either country qualify as credit.

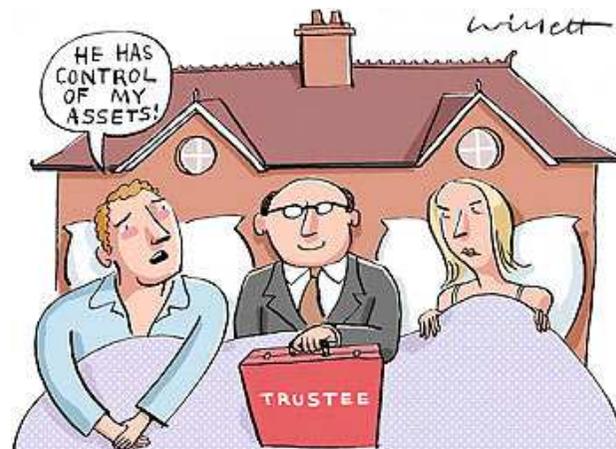


## Trusts

- A trust is a way of managing assets (money, investments, land or buildings) for people. There are different types of trusts and they are taxed differently.

Trusts involve:

- The 'settlor' - the person who puts assets into a trust.
- The 'trustee' - the person who manages the trust
- The 'beneficiary' - the person who benefits from the trust.



## Trusts

- The trust isn't a taxable entity, and all the trust's revenues are referring to the trustee's taxable income.

According to the trust reform, which became legislation in March 10, 2015 (known as Amendment 197):

- For trusts which are established by foreign residents or by a settlor who was a foreigner when he passed away, and which included at least one Israeli beneficiary, the trustee must report their revenue each fiscal year starting 1/1/14 and pay the applicable taxes.
- Each Israeli beneficiary must report all of the trust's distributions for which he is entitled as part of his taxable income.



## Relatives Trust

1. Trust which is an Israel beneficiary trust:

- ❖ From the establishment of the trust, all settlors are foreign residents.
- ❖ At least one of the beneficiaries is an Israeli resident.

2. The settlor is a relative of the beneficiary.



## Relatives Trust taxation

- There are 2 possible tracks to tax a Relatives Trust:
    - 25% on the trust's profits in the tax year including active and passive income.
  - Or
  - 30% on each distribution to the beneficiaries.
- ✓ As an “Oleh Hadash”, one is entitled to a tax exemption for the first 10 years.

## Voluntary disclosure

- The tax authorities have begun operations against Israeli residents who have unreported income from financial assets and real estate assets from Israel and abroad, as part of their annual tax reports.
- In order to encourage individuals and entities to reports these assets, the tax authority disallows the initiation of criminal proceedings against those who are willing to enter **a voluntary disclosure program**. This opportunity is given once in a life time.
- The income tax disclosure process enables the taxpayer to declare unreported assets, pay the applicable tax, and avoid criminal charges.



**GLOBES**  
ISRAEL'S BUSINESS ARENA

## Four suspects questioned on unreported HSBC accounts



The Israel Tax Authority has a list of 8,000 Israelis with accounts in HSBC Switzerland. Arrests are imminent.

**THE JERUSALEM POST**

## Tax Authority nabs 8,000-person list of Israeli HSBC accounts

Having a Swiss bank account is not illegal in Israel as long as it is reported to authorities and taxes are paid.



Swiss flag. (photo credit:REUTERS)

## Pension

- Most treaties with Israel determine that pensions and other similar remuneration which are paid to an individual shall be taxable only in the state in which he is a resident.
- Given the fact that “Oleh Hadash” is exempt for all income derived outside of Israel for the first 10 years, a pension which is paid for his time outside of Israel will be exempt as well.
- At the end of 10 years the pension will be taxable in Israel, nevertheless, according to the Israel tax ordinance, the tax won't surpass the original tax the individual had to pay in case he didn't become an Israel resident.





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