

**Deloitte.**

# Taxation and Investment in Israel 2012

Reach, relevance and reliability



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# 1.0 Investment climate

## 1.1 Business environment

Israel is a parliamentary democracy. The government is headed by the prime minister, who is elected by popular vote every four years. The Knesset, the 120-seat unicameral parliament, also is elected every four years under a proportional representation system. The head of state is the president, whose duties are mainly ceremonial; the president is elected by the Knesset for a seven-year term.

Israel enjoys a diversified economy. Services, particularly financial and business services, are the most important component of Israel's economy. There are significant manufacturing activities in areas such as, electronics, communications and other high-tech industries. Medium and lower tech industries, such as chemicals, plastics and food, also are important sectors of the economy. Israel holds a comparative advantage in research and development activities (R&D), stemming from the emphasis placed on high levels of education and the benefits of subsidies and massive investment in military R&D.

Due to a dearth of natural resources in Israel, it is necessary to import raw materials and many goods and services, and the country depends on exports to pay for such goods and services. Israel's main imports are raw materials; investment goods (heavy machinery and vehicles); fuel; and diamonds. Leading exports are diamonds, electronics, software and chemicals. The electronics, software and telecommunications equipment industries have emerged as the most important sectors.

Foreign trade is the mainstay of the economy, and there has been a steady liberalization of Israel's trade regime. Successive Israeli governments have been committed to free trade. Europe and the U.S. are Israel's largest trading partners, with the U.S. the largest source of imports and the most important export destination. Asia accounts for most of the remaining trade.

Israel Free Trade Agreements			
Canada	Egypt	Korea (R.O.K.)	Turkey
Chile*	EU	Mercosur countries	Ukraine*
China*	India	Mexico	U.S.
EFTA countries	Jordan	Romania	

\* Not yet signed

Globalization, combined with the deregulation of capital flows, has brought about an increase in Israeli investment abroad, both foreign direct investment and portfolio, and a subsequent stream of income inflows from dividends and interest.

Israel is a member of the UN, the International Monetary Fund, the World Trade Organization and the OECD.

### Price controls

The government can impose price controls on goods and services supplied by a monopoly or within the framework of restricted trade. Controls may also be imposed if there is a large concentration in the supply of a good, if the goods and services are subsidized, or if the producers receive support from the state budget. The government is authorized to impose price controls on goods and services deemed vital to the country.

### Intellectual property

Patents, trademarks, copyrights and industrial designs are legally recognized in Israel, and there is adequate enforcement of secured property rights. In extreme cases, criminal charges can be filed against violators of intellectual property laws. Infringement of patents, trademarks and designs in Israel usually result in civil remedies, including an injunction and damages. For flagrant

infringement, a company may sue for double damages. An exclusive licensee of a patent recorded in the patent registry may sue in its own name for an injunction to prevent continuing abuse.

## **1.2 Currency**

The currency in Israel is the New Israeli Shekel (NIS).

## **1.3 Banking and financing**

A vibrant banking sector has long dominated Israel's financial system and plays a vital role in the overall economy.

Commercial banks offer a full range of retail and corporate banking services: brokerages in the local and foreign capital markets; mortgages, leasing and other forms of finance; underwriting and investment banking services; mutual fund and other asset management facilities; and numerous specialist services.

The central bank, the Bank of Israel, defines and implements monetary policy, promotes and enforces regulations on local banks and foreign banks operating in Israel, supplies notes and coins, and manages the state's foreign currency.

With few exceptions, all financial institutions are headquartered in Tel Aviv, the country's business and financial center.

## **1.4 Foreign investment**

The government encourages foreign investment and provides an attractive package of government subsidies, tax and other benefits. Prior approval is generally not required except for investment in regulated entities, such as banks and insurance companies, and investment is only restricted in strategic sectors (e.g. defense).

The main focus of investment is high technology, which includes communications and internet software, biotechnology and medical instrumentation. Other sectors that have been important foreign direct investment targets include traditional industries and services (notably banking and insurance), R&D activities, tourism and real estate.

The Israeli Investment Center (IIC) at the Ministry of Trade and Industry is the agency whose main responsibility is to encourage the development of industry (and tourism).

## **1.5 Tax incentives**

### **Law for the Encouragement of Capital Investment:**

The Law for the Encouragement of Capital Investments aims to strengthen Israel's industrial capabilities. Companies that qualify for benefits under the law will be entitled to reduced rates of tax and/or grants.

Significant changes were made to the capital investments law in 2011; the "development zones" were reduced, benefits for companies with foreign ownership abolished, and the alternative and "Ireland" tracks eliminated. Companies that were eligible for benefits under the previous rules can elect to continue to receive such benefits instead of the benefits under the revised law. Moreover, under the revised law, approval from the IIC is no longer required to enjoy tax benefits. IIC approval is required only to obtain "Approved Enterprise" status, which may entitle the enterprise to certain investment grants.

Under the revised law, an enterprise wishing to enjoy benefits must be qualified as a Preferred Enterprise. To qualify for the revised benefits (i.e. Preferred Enterprise and Approved Enterprise), a company must: (1) be an industrial company registered in Israel; and (2) be internationally competitive (i.e. at least 25% of the company's total turnover is exported); or (3) most of its activities are in the field of biotechnology or nanotechnology, approved by the head of industrial R&D in Israel. Once a company qualifies for Preferred Enterprise status, there is no limit to the length of time the benefits will be granted.

The tax benefits are as follows:

- **Companies located in Priority Area A** are eligible for a reduced corporate tax rate of 10% in 2011-2012 (7% in 2013-2014);
- **Companies located in a Priority Area that is not A** are eligible for a reduced tax rate of 15% tax rate in 2011-2012 (12.5% in 2013-2014).

Generally speaking, companies qualifying for the reduced rates (i.e. Preferred Enterprises) are eligible for accelerated depreciation on assets used in the production of income. For the first five-year period of operation, the company may depreciate its assets for tax purposes at 200% of the ordinary rate of depreciation for equipment and 400% of the ordinary rate for buildings.

Dividends distributed by a qualifying company to Israeli corporate shareholders are exempt from tax if the distribution is made out of qualifying income; dividends distributed to non-Israeli companies are subject to a 15% withholding tax unless the rate is reduced under a tax treaty.

In addition to the reduced corporate income tax rate, an industrial enterprise located in development zone A is entitled to a grant if its comprehensive investment plan meets specified criteria. Grants are distributed by the Investment Center at the rate of 20%-24% of the total investment.

### Strategic program

Under the revised law, tax benefits may be granted to multinational companies, qualified for "Special Preferred Status," whose annual gross receipts exceed NIS 20 billion, invest at least NIS 10 million in a project and hire at least 250 new employees. The tax benefits include a reduced income tax rate of 5% for enterprises located in Priority Area A and an 8% corporate tax rate in all other cases.

### R&D benefits

The Office of the Chief Scientist (OCS) is responsible for promoting industrial R&D that is likely to yield new export products, and R&D benefits may be available. The OCS supports projects from the pre-seed stage to start-up companies to mature industrial R&D enterprises. The support focuses on the development of novel products based on new and innovative technologies of companies in the high-tech and "low-tech" sectors. A qualifying company will be entitled to funding at a rate of 20% to 50% of the program's approved budget. R&D programs that take place in an area defined as "Development Area A" are eligible for an additional 10% support grant.

### New and returning residents

Israeli tax law grants incentives for new Israeli residents and veteran returning residents (i.e. returning residents who have been outside of Israel for at least 10 consecutive years) and to returning residents (i.e. residents who have been outside Israel for at least six consecutive years).

A new Israeli resident and a veteran returning resident generally are entitled to a 10-year exemption for all types of income and capital gains sourced overseas; and for a filing exemption for income and assets outside Israel and thus are not required to report any income and capital gains generated outside the country for the 10-year period. However, Israeli-source income and capital gains are reportable and taxable under the normal rules. A returning resident is generally entitled to a five-year exemption for passive income and a 10-year exemption on capital gains derived overseas.

### Free trade zone

Eilat, the most southern city in Israel, is considered to be Israel's free trade zone. Basically, import of goods to Eilat is exempt from VAT and other indirect taxes. However, the exemption is given only to the extent the goods are sold, used or consumed in Eilat.

## 1.6 Exchange controls

There are no foreign currency restrictions. All activities and transactions in foreign currency are permitted, except for those specifically restricted or prohibited (e.g. money laundering). Individuals are permitted to invest abroad in financial and real assets.

## 2.0 Setting up a business

### 2.1 Principal forms of business entity

The usual corporate forms used for doing business in Israel are the private and public limited company, although there is little distinction between the two. A public company is a company registered on the Tel Aviv stock exchange or one that offers its shares to the public on any other stock exchange. All other companies are private companies. A company created for a public purpose is called a company for the benefit of the public.

Companies can participate in co-operative societies, limited partnerships and joint ventures. Co-operative societies exist mainly in the agriculture, marketing, retailing, transport and freight services sectors. A member's share may not exceed 20% of the society's capital and shares may not be transferred. A joint venture is similar to a co-operative venture, but separate liability is attached to the obligations of each party.

A partnership – general or limited – may be used. Partnerships in Israel are not separate entities for tax purposes, but act as conduits in passing through income and losses to the partners.

Business in Israel also may be carried out through a branch (foreign company).

#### Formalities for setting up a company

After complying with the formal requirements described below and paying a registration fee, a firm will be registered as a legal entity in the Registrar of Companies. Registration documents are usually filed in Hebrew, with financial data expressed in shekels, although corporate documents in English are accepted. There are no restrictions or special requirements for registering a company's capital in foreign currency, although in practice, this is rare.

#### Forms of entity

##### Requirements for a limited company

**Capital.** There is no official minimum capital requirement for setting up a company, and a company may provide capital in the form of goods or intangibles, valued under generally accepted accounting principles. The IC reviews the valuation of non-cash capital contributions to a company seeking investment incentives. There are no requirements for a legal reserve to set aside profits.

**Founders, shareholders.** There are no minimum requirements on the number of founders or shareholders or on the nationality or residence of shareholders. However, a private company may not have more than 50 shareholders.

**Board of directors.** A private company must have at least one director. A public company must have at least two external directors and a chairman, so that, in practice, there are at least three directors, and usually more to ensure a majority for shareholders. There are no nationality or residence requirements.

**Management.** Companies generally operate through the general shareholders' meeting and the board of directors, the latter of which are elected at the general shareholders' meeting. There is no minimum number of managers for a private company, but a public company must have at least one who serves as the chief executive officer (CEO). The CEO generally may not serve as the chairman of the board of directors. There are no nationality or residence requirements, but residence must be stated in founding documents and annual reports.

**Taxes and fees at incorporation.** A filing fee of about NIS 2,500 is levied at the time a company is registered.

**Types of shares.** Shares with cumulative voting rights are allowed, but public companies registered on the Israeli stock exchange may not issue non-voting shares. The most common types of shares issued are ordinary, preferred and deferred. Redeemable shares may be issued, but must have preferred status. Companies may acquire their own ordinary shares in certain cases.

**Control.** A minority exceeding 25% may block major decisions. Election of board members usually requires a simple majority (more than 50%) of voters in attendance. Institutional investors (provident and unit trusts/mutual funds) holding more than 5% of a company must attend general assemblies and vote.

### **Branch of a foreign corporation**

A foreign company may operate in Israel through a branch, although most foreign companies prefer to set up a local subsidiary. Only companies registered in Israel are eligible for approved status (which qualifies a project for special incentives and assistance), and branch managers are personally liable for certain company obligations, such as money owed to employees.

To set up a branch, a foreign company must file a certified copy of its charter and statutes with the Registrar of Companies, submit a list of directors together with names and addresses of representatives authorized to act on behalf of the company in Israel and indicate the country in which the head office is incorporated in any prospectus and on bills, invoices, letterheads, announcements and advertisements. After the branch is established, the head office must present an annual financial statement to the Registrar of Companies. The registration fee is adjusted annually based on the cost-of-living index. There is no capitalization fee.

A foreign company operating through a branch (rather than a subsidiary) is generally subject to tax only on income derived from local operations of the branch. A branch is subject to tax at the standard corporate rate on Israel-source income and capital gains. Distributions from an Israeli branch to the foreign head office are not subject to tax in Israel (i.e. there is no branch tax).

## **2.2 Regulation of business**

### **Mergers and acquisitions**

Under the Restrictive Trade Practices Law, notices of mergers and acquisitions must be filed with the Director-General of the IAA in the following instances:

- The transaction results in control of more than 50% of the production, sale, marketing or purchase of a product or service, or group thereof;
- The combined turnover in Israel of the entities involved exceeds NIS 150 million in the financial year before the proposed merger; or
- One of the entities involved already operates a monopoly as defined in Israeli law.

A merger for these purposes is defined as the acquisition of the principal assets of one entity by another or the acquisition of shares in such an entity involving control of more than 25% of the issued share capital, voting rights, rights to appoint directors or participation in profits.

Acquisition can be direct or indirect, including via a voting agreement. These provisions generally apply to both companies and partnerships, and the review takes into account not only the direct parties to the transaction, but also entities controlled, controlling or under common control.

Mergers generally may proceed after the expiry of a 30-day filing period. The IAA can issue a decision blocking the merger within that period if the merger creates a substantial likelihood that competition and a relevant market will be significantly harmed. An unfavorable decision can be appealed to the Antitrust Tribunal and then to the Israeli Supreme Court.

Mergers in the manufacturing, shipping and hotel industries are welcomed with tax waived on the resulting capital gains if the merger contributes to the common good and the Ministry of Finance has approved the merger.

### **Monopolies and restraint of trade**

Israeli law contains measures to prevent the creation of monopolistic organizations, by merger or other means, when the resulting entities might interfere with free competition and harm the well-being of consumers.

The Israeli Antitrust Authority (IAA) deems a monopoly to exist when more than 50% of the total supply or acquisition of an asset, or more than 50% of the total provision or acquisition of a service, is concentrated in the hands of a single entity. Because Israel's market is small and had been accustomed to many trade restrictions (although these are now largely abolished), barriers to



entry and exit are relatively high and market dominance by major producers is common. Although monopoly producers control a number of sectors (oil refining, steel, cement, glass, potash and certain foods), even more sectors are controlled by only two or three major competitors. The IAA frequently uses its power to direct monopolies to refrain from harming competition.

Once proclaimed a monopoly, a presumption is created on the definition of the market, the applicable market share and the existence of market power, thereby facilitating private actions and class actions against the monopoly for abuse of monopoly position. A firm that is defined as a monopoly by law, particularly if it has been proclaimed as such by the IAA, is subject to legal restrictions. A monopoly also may be subject to price regulation, although not by the IAA, which does not regulate prices. In practice, however, this measure is rarely used.

### **2.3 Accounting, filing and audit requirements**

A private company must present an annual financial statement inspected and confirmed by a certified auditor to the Registrar of Companies. Material corporate developments, such as the appointment or replacement of directors, must be reported to the Registrar. A public company is subject to the Israel securities authority and must present its annual financial statement to the authority. Companies quoted on the Tel Aviv stock exchange must publish detailed quarterly income statements and balance sheets, including purchasing power effects on profit-and-loss figures. They must issue statements disclosing any material developments in their affairs as and when these occur.

Publically traded Israeli entities must file financial statements in accordance with IFRS; entities that are not publically traded may file their financial statements in either IFRS or Israeli GAAP.



# 3.0 Business taxation

## 3.1 Overview

The principal taxes in Israel are income tax, capital gains tax, VAT and land appreciation tax. An extensive system of withholding income tax exists for payments of salaries and other types of income. National insurance contributions are payable by both employers and employees. Israel does not impose an excess profits or alternative minimum tax. There are no basic differences in the tax regime applied to different forms of business entities.

Israel operates a classical system of taxation, under which corporate taxation is imposed at the level of the company and again when the income is distributed to shareholders. The amount of tax to be paid is calculated via a form of self-assessment, reviewed by the tax authorities.

Israel has a special tax regime for holding companies, and as discussed above in 1.5, tax incentives are available.

The primary law on income taxes is the Income Tax Ordinance, and taxes are administered and collected by the Israeli Tax Authority.

## 3.2 Residence

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

## 3.3 Taxable income and rates

Corporate income tax is imposed on the worldwide income of Israeli residents. An Israeli branch of a nonresident company is taxed as though it were a regular resident company with respect to all of its profits derived from, accrued or received in Israel. Nonresidents are taxed only on Israeli-source income.

The basic rate of company tax on net taxable income is 25%.

A special tax regime applies to Israeli holding companies that invest in foreign corporations. These benefits are offered to private corporations incorporated and managed in Israel provided, inter alia, the company has a minimum investment of NIS 50 million in shares and loans of foreign subsidiaries resident in countries that have concluded a tax treaty with Israel. Eligible corporations will be entitled to a participation exemption on dividends received from foreign subsidiaries and on capital gains derived from the sale of shares in 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 will be taxed at 5%, rather than the normal rate (25%-30%).

### Taxable income defined

Taxable income is calculated based on annual financial reports, using generally accepted accounting principles, with necessary adjustments. Corporate tax applies to all income irrespective of where the income arises. Adjustments for inflation or currency appreciation are treated as ordinary income or expenditure.

In general, income may be classified as ordinary income, capital gains or passive income, such as dividends or interest. Income from business operations usually is treated as ordinary income, which is subject to the standard corporate tax rate. Israeli resident companies are liable for capital gains tax on their worldwide capital gains, and are subject to the standard corporate tax rate.

Dividends received by an Israeli resident company from another Israeli company are tax-exempt if the dividends arise from income produced or accrued in Israel. Dividends received by an Israeli company from income produced or accrued abroad are taxed at a corporate rate of 25%, with a credit granted for tax withheld at source.

Interest is subject to the regular corporate tax rate to the extent it is attributed to business operations.

## Deductions

Current revenue expenses incurred in producing income are deductible (e.g. interest and royalties); capital and private expenses are not deductible. Dividends are not deductible from income (corporate taxes are paid on income before distribution of dividends).

An investment in the shares of a company whose main activity is R&D may be deductible as an expense for tax purposes over a five-year period.

## Depreciation

Fixed assets may be depreciated at statutory rates and deducted in computing taxable profits. The rates and amounts used in tax computations may differ from those used in compiling the company's financial reports. Allowances are not available for expenditure on land and residential homes. Depreciation for tax purposes is calculated on a straight-line basis.

Industrial companies purchasing new equipment may elect to use a modified declining balance method on an asset-by-asset basis, but the election is irrevocable for the life of the asset. Higher depreciation rates apply to industrial equipment used for more than one shift. Assets may not be revalued for tax purposes.

As noted above in 1.5, Enterprises qualifying for reduced rates (i.e. Preferred Enterprises) are entitled to accelerated depreciation on certain assets in certain circumstances.

Patents held by industrial companies are depreciable over eight years. Under certain conditions, capital expenditure for R&D may be written off in three equal annual installments. With the special approval of the OCS, R&D expenditure used to finance R&D projects may be written off in one year.

## Losses

Trading or business losses may be offset against income from any source in the same year. Losses may be carried forward indefinitely from one income year to another, linked to the consumer price index, to be offset against income from trade or business, including capital gains from trading or business activities. Losses may not be carried back.

## 3.4 Capital gains taxation

An Israeli resident is subject to capital gains tax on the disposal of all its assets, regardless of whether the assets are located in Israel or abroad.

Capital gains from the sale, exchange, transfer or other disposition of most types 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 subject to capital gains tax.

The capital gains tax rate depends on the nature of the seller, the purchase date and the nature of the asset. The general rate for companies is equal to the standard corporate income tax rate, currently 25%.

If the seller was a corporate entity subject to the Inflationary Adjustments Law as of 2006, it will continue to be subject to the corporate tax rate on gains derived from the disposal of traded securities purchased before 1 January 2006. The inflationary component of the gain is exempt from tax.

Shares and other securities of Israeli companies, or shares and other securities of non-Israeli companies holding significant assets in Israel, may be treated as Israeli assets. However, persons that are not resident in 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 on gains from the sale of shares of Israeli companies traded on stock exchanges overseas acquired after listing, unless the gain is attributable to a permanent establishment (PE) of the seller in Israel.

## 3.5 Double taxation relief

### Unilateral relief

Under Israel's unilateral relief provisions to alleviate double taxation of income, a direct foreign tax credit is available for foreign taxes paid on non-Israeli source income.

Subject to restrictions and the fulfillment of certain conditions, an Israeli company may elect to apply an indirect credit, i.e. an Israeli company will be subject to Israeli corporate tax on a grossed up dividend and entitled to an indirect foreign tax credit (i.e. underlying corporate tax and direct tax withheld on the distribution by a foreign company). The indirect credit may be granted if so provided under a tax treaty or if the Israeli company holds directly at least 25% of the foreign company's "means of control" for distributing the dividend. Additional criteria may apply for indirect holding structures.

### Tax treaties

Israel has a solid tax treaty network, the aim of which is to eliminate double taxation and provide for reduced rates of withholding tax on dividends, interest and royalties. The treaties generally follow the OECD model treaty, providing for relief from double taxation on all types of income, limiting the taxation by a contracting state of companies resident in the other contracting state; and protecting companies resident in one country from discriminatory taxation in the other. Israel's treaties adhere to the internationally agreed exchange of information requirements.

To obtain tax benefits under a tax treaty in Israel, it is necessary to demonstrate beneficial ownership of the income and furnish a tax residence certificate issued by the tax authorities of the other contracting state.

Israel Tax Treaty Network			
Austria	Georgia	Mexico	Spain
Belarus	Germany	Moldova	Sweden
Belgium	Greece	Netherlands	Switzerland
Brazil	Hungary	Norway	Taiwan
Bulgaria	India	Philippines	Thailand
Canada	Ireland	Poland	Turkey
China	Italy	Portugal	Ukraine
Croatia	Jamaica	Romania	U.K.
Czech Republic	Japan	Russia	U.S.
Denmark	Korea (R.O.K.)	Singapore	Uzbekistan
Estonia	Latvia	Slovakia	Vietnam
Ethiopia	Lithuania	Slovenia	
France	Luxembourg	South Africa	

## 3.6 Anti-avoidance rules

### Transfer pricing

Israel's transfer pricing rules, which are based on the OECD guidelines, apply to transactions between an Israeli resident and a related nonresident. The rules apply when a "special relationship" exists between parties to a transaction, which includes the relationship between an individual and his/her relatives, control by one party to the transaction over the other, or control by one individual over the other parties to the transaction, whether direct or indirect, individually or together with other individuals.

The following transfer pricing methods may be used: CUP, cost plus, resale price, TNMM, profit split, residual profit split and other unspecified methods. Preference is given to transaction-based methods over profit-based methods.

Documentation requirements apply. Documentation should include: (1) a description of all entities involved in cross-border transactions; (2) an industry description and market trends; (3) functional and risk analysis; (4) holding and ownership structures; (5) intellectual property ownership; (6) primary contracts; (7) selection of method; (8) selection of profit level indicator; (9) description of comparable transactions/companies; (10) economic results; (11) adjustments performed; and (12)

opinions provided. There is no statutory deadline for the preparation of documentation, but it must be submitted within 60 days of a request by the tax authorities.

An annual declaration form of all controlled transactions, prices, and terms must be filed with the annual income tax return, including a corporate officer's declaration of what constitutes arm's length prices and the terms of reported controlled transactions.

Advance pricing agreements may be obtained.

### **Thin capitalization**

Israel does not have thin capitalization rules.

### **Controlled foreign corporations**

Under the CFC rules, an Israeli resident that controls a foreign corporation that derives most of its income or profits from passive income is subject to tax on a pro rata portion of the foreign corporation's undistributed profits as if the profits were distributed as a dividend.

The CFC rules generally are triggered where an Israeli resident holds at least 10% of the means of control of a CFC ("significant shareholder") that has accumulated undistributed passive profits and is taxed at a rate lower than 20% in its country. In that case, the Israeli resident will be treated as if it had received its proportionate share of the CFC's profits as dividend income ("deemed dividend"). Deemed dividend received by a corporation will be subject to the standard corporate income tax rate in Israel (currently 25%); and, will be subject to income tax at a rate of 30% if received in the hands of an Israeli individual shareholder. A deemed tax credit (deemed credit) will be granted to the Israeli controlling shareholder in the amount of the foreign tax that would have been paid if the undistributed passive profits had been distributed as dividends.

### **General anti-avoidance rule**

An assessing officer may disregard a transaction if he/she concludes that the transaction was carried out artificially to reduce tax liability or if one of its principal objectives of the transaction is improper avoidance or improper reduction of tax.

## **3.7 Administration**

### **Tax year**

The tax year is generally the calendar year, although certain companies may apply to use a different year in special circumstances.

### **Filing and payment**

A company is required to file its annual tax return no later than five months after 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 according to monthly turnover. Most firms make 12 monthly advance payments at a fixed percentage of turnover. Alternatively, a company may be required to make 10 monthly payments, beginning in the second month of the tax year, with each payment a fixed percentage of the previous year's tax assessment.

Penalties apply if advance payments are overdue or if tax returns are filed late. The balance of any taxes due is payable from the beginning of the following tax year and is linked to the consumer price index. Any overdue tax balance attracts interest at an additional 4% until paid in full.

### **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, although if certain conditions are satisfied, qualified "industrial companies" are entitled to file a consolidated return for tax purposes.

## Statute of limitations

An assessing officer may, within three years after the end of the tax year in which a return was submitted (within four years after the end of the relevant tax year with the approval of the head of the tax authorities), examine a return and approve the self-assessment or determine to the best of his/her judgment the amount of the taxpayer's income. The same period applies for the collection of tax.

## Tax authorities

The Israeli Tax Authority is in charge of the collection of direct and indirect taxes, including VAT and real estate taxes. The Authority has several regional and national units: assessing offices, VAT offices, real estate taxation offices, custom houses, collection enforcement and departments of VAT and income tax investigations.

## Rulings

There is an institution for tax resolutions, under which the authorities address rulings and tax resolutions that set out the expected tax liability of a future transaction. Binding decisions are published, with no details of the specific taxpayer.

## 3.8 Other taxes on business

### Petroleum profits taxation

The petroleum profits tax is levied on the exploitation of oil and natural gas. The regime aims to ensure natural gas development, provide incentives to operators in the business sector and take account of environmental concerns. Key features of the petroleum tax law are as follows:

- A 12.5% royalty is levied on the fair market value of the petroleum at wellhead.
- Tax benefits include:
  - Recognition of capital expenditure as current expenses;
  - Depreciation on land (expenses incurred on the acquisition);
  - Current deduction of capital losses arising from the abandonment of an oil asset;
  - Carryforward of deductions to future years against any income; and
  - An exemption from custom duties and other import taxes when importing to Israel.
- An initial levy of 20% is imposed on profits from oil and gas, gradually increasing to 50%, depending on the levy coefficient (R-Factor). The R-Factor refers to the percentage of the amount invested in the exploration, development and establishment of the project, so that the 20% rate will be imposed only after a recovery of 150% of the amount invested (R-Factor of 1.5) and will go up to 50% after the recovery of 230% of the amount invested (R-Factor of 2.3). The rate may be reduced to the extent the corporate income tax rate is higher than 18% (the corporate rate currently is 25%, so the maximum levy rate is 45.52%).
- Special benefits are granted to enterprises that initiate the commercial production stage before 1 January 2014.
- Accelerated depreciation of accumulated costs during the lease period of the development of oil and gas assets is available at a rate of 10%. The oil rights holder may elect one of the following options:
  - A fixed rate not to exceed 10%; and
  - With respect to any deductible asset, depreciation equal to taxable income (before accelerated depreciation), but not exceeding 10%.
- A partner's share in the oil partnership is calculated according to its share in the partnership's taxable income or losses according to the Israeli tax code, so that the deductions and losses initially will be made at the partnership level and then attributed to each of the partners when calculating the partner's taxable income. The general partner will be subject to the partnership's reporting liabilities and will file its annual tax return.

## 4.0 Withholding taxes

### 4.1 Dividends

Dividends received by an Israeli resident company from another Israeli company are exempt, provided the dividends arise from income produced or accrued in Israel. Dividends paid to a resident individual are subject to a 25% withholding tax, although individuals classified as "significant shareholders" (holds more than 10% in one of the controlling means of the company) is subject to a 30% withholding tax rate on dividends.

A 25% withholding tax is levied on dividends paid to a non-controlling foreign resident (i.e. one that holds less than 10% of the shares of the Israeli payer); otherwise, the rate is 30%. These rates may be reduced under a tax treaty.

Additionally, dividends paid by an Israeli holding company (see section 3.1) to nonresident shareholders will be taxed at 5%, rather than the standard rate.

### 4.2 Interest

Interest paid to an Israeli corporation is subject to the corporate standard tax rate (currently 25%). Interest paid to a foreign corporation is subject to a 25% withholding tax, which may be reduced under a tax treaty.

Interest paid to a resident individual is subject to a 15% withholding tax on nominal interest payments and 25% on interest payments that are index-linked. Individuals classified as "significant shareholders"/employees of the paying company/service provider or selling products to the paying company may pay the marginal tax rate on interest payments (currently up to 48%). These rates also apply for interest payments made to nonresident individuals, unless the rate is reduced under a tax treaty.

Interest payments to a nonresident for debentures issued by an Israeli corporation that are traded on the Israeli stock exchange are exempt from withholding tax in Israel unless the gains are attributable to the nonresident's PE in Israel, the foreign bond holder is a "significant shareholder" in the bond issuing Israeli company or is considered to be "related to" or to have a "special relationship" with the bond-issuing Israeli company.

### 4.3 Royalties

Royalties paid to nonresidents (corporations and individuals) are subject to a 25% withholding tax unless the rate is reduced under a tax treaty.

### 4.4 Branch remittance tax

Israel does not levy a branch remittance tax.

### 4.5 Wage tax/social security contributions

An employer is required to deduct wage tax and social security at source and remit the appropriate amount to the ITA. The monthly social security brackets for Israelis aged 18 to retirement age (62-67) are 3.45% for income up to NIS 5,171 and 5.9% for income up to NIS 41,850.

## 5.0 Indirect taxes

### 5.1 Value added tax

Value added tax (VAT) applies to the supply of most goods and services, including imported goods and services at each level (including importing, manufacturing, distributing, wholesaling and retailing).

The standard rate is 17% (increased from 16% on 1 September 2012). Certain items are zero-rated, including exported goods, intangible goods sold to foreign-residents and the provision of certain services to foreign-residents, tourism services, the transport of cargo to and from Israel, the sale of most goods to the Eilat free-trade zone, and the sale of fresh fruit and vegetables. VAT-exempt goods and services include residential rent, transactions of very small businesses (defined as "exempt dealers", having an annual turnover of up to 76,664 NIS) except for real estate transactions; and, sales of goods where the input VAT was not deductible.

The value of imported goods for VAT purposes includes the customs duty, purchase tax and other levies. Each supplier of goods and services collects VAT on the total costs for that stage of production or distribution.

Financial institutions may neither charge VAT on their revenues nor claim the VAT included in their expenditures. Instead, financial institutions are liable for a tax on wages and profits, but at the 17% rate. A similar wage tax applies to nonprofit organizations, at a reduced rate of 7.5%.

Dealers, nonprofit organizations and financial institutions must register with the VAT and Customs Authority. In general, a nonresident with a business or activity in Israel must register for VAT purposes.

A foreign company registered in Israel, or a non-registered foreign company, whose main business or activity is abroad and also carries on an activity or business in Israel shall appoint, within 30 days from the date of commencing his activity in Israel, a Physical representative whose permanent place of residence is in Israel.

The collected VAT needs to be transferred to the VAT authorities periodically (monthly or every two months – depends on the annual expected turnover. Turnover of more than approximately 1,500,000 NIS requires a monthly report).

Electronic reporting is mandatory as from 2010.

VAT grouping is permitted under certain conditions.

### 5.2 Capital tax

Israel does not levy capital duty.

### 5.3 Real estate tax

The land appreciation tax is payable on capital gains derived from the sale or transfer of real estate, under principles that are similar to the capital gains tax:

- The betterment, in real terms, is subject to the standard corporate tax rate (currently 25%).
- The inflationary betterment is exempt from tax, except for tax at a rate of 10% that would be imposed on the inflationary betterment arising from the purchase date until 31 December 1993.
- A purchaser of real property is subject to purchase tax (acquisition tax) at a rate of up to 5%.

### 5.4 Transfer tax

See under 5.3.



## **5.5 Stamp duty**

Stamp duty on signed documents was abolished in 2006.

## **5.6 Customs and excise duties**

Customs duties are levied on several imports. Excise taxes apply to fuel, alcohol and tobacco.

The rates of customs and purchase tax are determined according to each product's classification in the customs and purchase tax Tariff (Harmonized Commodity Description and Coding System). VAT (current rate in Israel is 17%) is levied upon the total amount (including the customs and purchase tax).

## **5.7 Environmental taxes**

There are no environmental taxes; however, certain tax benefits and incentives granted for the use of low co2 emission cars.

## **5.8 Other taxes**

### **Purchase tax**

Purchase tax is levied on certain imports or local industrial production and is collected from local manufacturers 30 days after the month in which the goods are sold and from the importer when goods are released from customs.

## 6.0 Taxes on individuals

Israeli residents are subject to individual income tax, social security tax and capital gains tax on a worldwide basis. Nonresidents are taxed on income sourced in Israel.

The Israeli tax system moved from a territorial system to a personal system in 2003.

### 6.1 Residence

An individual is resident in Israel if his/her “center of vital interests” is in Israel. (The definition is a combination of criteria defined in case law and as used in practice.) The number of days an individual spends in Israel and overseas also affects residence status: an individual will be deemed to be resident if he/she spends 183 days or more in Israel or if in the current tax year he/she spends 30 or more days in Israel, and the total period of the stay in Israel in the tax year and in the two preceding tax years cumulatively amounts to 425 days or more.

An individual is considered a foreign resident if he/she left Israel for two consecutive years (183 days in each year), followed by two consecutive years in which his/her center of vital interests was located abroad.

### 6.2 Taxable income and rates

#### Taxable income

Israeli resident individuals are taxed on worldwide income. Nonresident individuals are subject to tax only on Israeli-source income. New Israeli residents and senior returning residents are entitled to a 10-year tax exemption for certain types of income starting from the date of immigration/return to Israel (extendable for a maximum additional 10-year period if certain criteria are met).

Taxable income includes, but is not limited to, employment income, business income, income from dividends, interest, rents and royalties and pension income. Employment income includes most fringe benefits, as well as wage and salary income. Rules similar to those applying to corporations apply in the case of business income.

A tax exemption is available on capital gains from the sale of Israeli securities purchased by nonresidents as from 1 January 2009, provided the gains are not attributable to a PE of the seller in Israel and the company's assets are comprised mainly of real estate. The tax exemption should apply only to the extent the seller reports the sale to the tax authorities.

#### Deductions and reliefs

Individuals may deduct contributions to a self-funded approved provident or pension fund.

Individuals investing in the shares of a start-up company whose main activity is R&D may deduct their expenditure over three-year period against any source of income.

#### Rates

The personal income tax rates are progressive starting at 10% and increasing to a top rate of 48%.

The rates of tax on unearned income are 25% on dividends, 15% on nominal interest payments and 25% on interest payments that are index-linked. Individuals classified as “significant shareholders” pay a 30% tax on dividends. The capital gains tax on all investments of households is 25% (and 30% for significant shareholders (i.e. holders of more than 10% of the company)).

### 6.3 Inheritance and gift tax

Israel does not levy inheritance and gift tax.

### 6.4 Net wealth tax

Israel does not levy a net wealth tax.

## 6.5 Real property tax

Property "betterment" tax is applicable to the sale of real-estate property. The principles of the property betterment tax are similar to those of the capital gains tax.

- With respect to assets purchased before November 7, 2001, the betterment in real terms derived from the purchase date up to November 7, 2001, is subject to the marginal individual tax rate (currently, up to 48%).
- The betterment in real terms derived from November 7, 2001, and up to January 1, 2012, is subject to the marginal individual tax rate and up to 20%.
- The betterment in real terms derived as from January 1, 2012, and on is subject to the tax rate of 20%; or, to the extent the individual is a "significant shareholder" (i.e. holds more than 10% of the controlling means), he is subjects to a betterment tax rate of 30%.

The inflationary betterment is exempt from tax, except for tax at a rate of 10% that would be imposed on the inflationary betterment arising from the purchase date until 31 December 1993.

A purchaser of real property is subject to purchase tax (acquisition tax) at a rate of 5%. However, rates ranging from 0%-5% apply to the purchase of a residence.

## 6.6 Social security contributions

Israeli employees generally pay social security at a certain rate of their wages, with the contribution deducted at source by the employer. Social security is levied as follows: up to NIS 5,171, 0.4% and up to NIS 41,850, 7%.

## 6.7 Other taxes

A health contribution at a rate of 3.1%/5% of salary is levied on individuals. The tax is deducted at source by the employer if the individual is employed or is paid by the individual if self-employed or unemployed. Some exemptions are available, generally if the individual is unemployed.

## 6.8 Compliance

The tax year is the calendar year.

Resident individuals generally are required to file an annual personal tax return, unless the main source of income is employment income (and up to the income ceiling determined by law), which is withheld by the employer at source.

The tax return must be submitted by 30 April of the year following the tax year, with any tax due paid at the same time. A nonresident individual who has taxable income in a tax year is required to file an annual personal tax return.

# 7.0 Labor environment

## 7.1 Employees' rights and remuneration

The major statutes affecting labor are as follows:

- *Hours of Work and Rest Law*: A work day may not exceed 8.5 hours and a work week may not exceed 43 hours.
- *Equal Opportunities Employment Law*: The employer must pay both genders equal wages for similar work.
- *Severance Pay Law*: One month's wages must be paid for every year of employment to a person who has been employed continuously for one year or more by the same employer or at the same place of employment, and who has been dismissed.
- *Minimum Wage Law*: A full-time employee is entitled to a minimum salary of NIS 4,100 per month (it should be noted that the minimum salary is about to be update to 4,300 per month).
- *Work Safety Ordinance and the Labor Inspection (Organization) Law*: Ensures worker safety.
- *Settlement of Labor Disputes Law*: This law allows for the arbitration of disputes that have not been settled within a certain period.
- *Early Notice for Resignation and Dismissal Law*: Both the employer and the employee are entitled to notice when leaving the post or being dismissed. After a six-month period of employment, the early notice is 30 days.
- *Ladies Employment Law*: This law governs the employment of women during and after pregnancy.

### Working hours

The normal work week is five days, beginning on Sunday and ending on Thursday (or Friday midday, for those businesses still working Fridays). Overall working hours have been reduced to 43 hours per week. Industrial institutions normally operate eight to nine hours per day.

## 7.2 Wages and benefits

The minimum wage is NIS 4,100 per month and applies to all employees, both local and foreign.

Wages in foreign-owned firms generally are much higher than the minimum wage because foreign ownership is concentrated in high wage industries (notably electronics).

Fringe benefits in manufacturing in Israel vary under different collective agreements, but they generally amount to 40%-60% of base pay, or 20%-35% of gross wages, depending on the industry and status of the employee. Office workers receive slightly higher fringe benefits, often including annual bonuses up to one or two months' salary.

### Pensions

The retirement age is 67 for men and 62 for women.

### Social insurance

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 the employee's compulsory contributions to the national insurance scheme.

### Other benefits

Paid annual holiday leave is required to be at least 14 working days for each of the first four years of employment, up to a maximum of 28 days. Other benefits that must be provided are paid public

holidays; health insurance and sick pay; paid recreation; vocational training funds; and travel to and from work reimbursement.

Voluntary benefits often supplement mandatory benefits. Many employers provide work clothes, canteens and holiday bonuses, and maintain nurseries for children of working mothers. Women who return from maternity leave are entitled to a "breast-feeding hour," which means that they can work one hour less for the first four months after returning from maternity leave. A number of large concerns have introduced profit-sharing plans for both blue and white collar employees. Another benefit, typical to high-tech companies, is an employee stock ownership plan, under which employees are granted options, subject to vesting period and other requirements, for the company's shares.

### **7.3 Termination of employment**

Manufacturers are legally entitled to dismiss workers for cause. The Employment Authority must be notified about dismissals of more than 10 workers. Collective agreements ordinarily provide that, after six months on the job, an employee, even when paid on a daily basis, may be fired only for special cause and after consultation with the union.

Business considerations are increasingly accepted as the major consideration for dismissals, but seniority and employee needs are taken into consideration. Disagreements are settled by "parity" grievance committees and, if required, arbitration boards. The law imposes severance payments upon dismissal, upon retirement at the legal retirement age and in other specified circumstances. Severance is paid at the rate of one month of salary for every year of service, calculating the average salary of last three months of employment or, for daily workers and for those employed before 1993, 12 days' basic pay for every year of service. Higher amounts are often granted, especially in state-owned firms. Collective and some individual agreements provide for severance pay even when employees leave voluntarily. Severance pay for managers and professional workers is usually set out in the employment contract so they are entitled for severance pay even when they leave post voluntarily.

### **7.4 Labor-management relations**

In the past, trade union membership covered about 80% of Israel's labor force, but this ratio has shrunk steadily. However, many more employees are signatories to collective employment agreements, which may include affiliation with unions. Most unions are affiliated or cooperate closely with the Histadrut, the biggest trade union federation.

In general, good working relations exist between firms and unions. Collective agreements usually cover a two-year period.

Cooperation between employees and employers is a fundamental element of the Israeli work system. Negotiations in the private sector are not usually prolonged or accompanied by crises. The salary conditions fixed in the national agreement serve as minimum levels, with separate negotiations held subsequently for each industrial sector, between the employers and the trade unions. When a strike does take place, companies may apply to a labor tribunal for an injunction against the strike.

Arbitration may be required if so specified in a collective agreement, if either party to a dispute requests it or if the government considers arbitration advisable. There is usually a 15-day cooling off period. Special labor courts deal with cases concerning the interpretation of labor laws and existing collective agreements. The government has the right to appeal to labor courts for back-to-work orders for public services deemed "essential." Although the courts traditionally have been reluctant to issue such orders, they have been instrumental in bringing the parties back to the negotiating table.

Many firms are engaging their employees' services through personal employment agreements. These agreements are confidential and unions are not involved in the process. A personal agreement usually serves in place of a collective agreement, but regulatory orders may impose some terms included in collective agreements. An employee under a personal agreement is not allowed to be a member of a labor union, giving rise to certain special benefits in his/her personal agreement.

## 7.5 Employment of foreigners

Foreign employees are only partially covered by labor rights although labor courts tend to expand the rights of foreign employees. They are not allowed to join the Histadrut, but are covered by the terms of collective agreements. Non-documented foreign workers are not entitled to the full benefits granted by the national insurance institution, including maternity leave. The national health insurance does not cover foreign workers; this must be covered by the employer or by the employee. There are special agreements for foreign employees.

The government has introduced measures to reduce the number of foreign workers. The employer must pay NIS 1,140 per worker when submitting a request for an employment license, as well as a NIS 9,060 annual fees per employed foreign worker (NIS 1,140 per employed worker in agriculture). The maximum fine for employing workers without an employment permit is NIS 104,400. Officially, Israel imposes no limits on foreign managerial or technical personnel, but nonresidents need a work permit from the employment service. Work permits, which ordinarily take several weeks to obtain, are not normally issued for more than one year but can be renewed. Residents of the Palestinian Authority working in Israel must have permits from the employment service.

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