Tax

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Trends in Israeli Tax Law

Change of a Business Model - International Acquisitions of Israeli Hi-Tech Companies

International corporations are extremely interested in acquiring Israeli technology and start-up companies. Following such acquisitions, multinational corporations tend to restructure the business model of the acquired company by selling or licensing its intangible assets to a related party abroad, and following the transfer, the Israeli company may become a service provider of R&D services to the related company. Essentially, not only is the Israeli company acquired, but it also undergoes a change in its business model.

Over the past few years, the Israeli Tax Authority ("ITA") has started examining these business model changes more closely, particularly in cases of technology companies. The ITA examinations aim to ensure that intangible assets are not being transferred abroad at below market prices which inappropriately reduce the Israeli tax base. If a transaction is found to be made at below market value, the ITA may challenge the value of the intangible asset and attempt to adjust the transaction price to reflect the higher value. The adjustments in the transaction price subsequently impose additional tax liabilities on such transfers. The ITA may also require the reclassification of the licensing of an intangible asset as an asset sale. Additionally, after making an initial adjustment to a transaction, the ITA may attempt a secondary adjustment, which will impose an additional liability on the intercompany charge.

In recent years, the ITA has issued numerous tax assessments reclassifying business model changes which have resulted in increases of hundreds of millions of dollars in tax liabilities. Some of these assessments are still being negotiated with the ITA, while others are in the initial stages of being litigated in courts. Awareness of the current trends and developments in the area may allow the parties to plan their transactions ahead in a manner which will avoid such disputes with the ITA.

Tax Incentives for Foreign Residents in Israel

Israeli tax legislation is constantly being developed and modified to incentivize foreign residents to invest in Israeli companies. To that effect, several amendments adopted in recent years were legislated to alleviate the tax burden imposed upon foreign residents, and thereby, to make investments in Israel more attractive. One of the key examples of this trend is the exemption from capital gain tax.

According to current Israeli tax law, a foreign resident will be exempt from capital gains tax over the sale of shares in Israeli companies, if the capital gains are not derived from the operation of its permanent establishment in Israel. It is important to note that those exemptions may not apply where the majority of the company's assets consist of real estate or natural resources. Additionally, at this time, Israel is a party to more than 50 bilateral treaties which provide various forms of tax relief to foreign residents.

The Law for Encouragement of Capital Investments

Israel supports capital investment initiatives by developing and granting a wide range of incentives and tax benefits. These tools are designed to boost productivity in certain industrial sectors, encourage exports, increase Israel's overall economic revenues and promote its overall growth. To attain these goals, Israel has passed a number of laws such as the Law for Encouragement of Capital Investments ("the Encouragement Law").

The Encouragement Law went through several changes in recent years in an effort to redesign its provisions so that it will attract investors on the one hand, and it will be simplified to contribute to achieving its various goals on the other. The amendment also contained a moderate increase to the tax rate to be imposed on benefited enterprises following the application of the Encouragement Law's benefits. Today, the law includes two corporate tax rates: 9% for investment in certain rural areas the government wants to prioritize and 16% for other geographic areas. In addition, the withholding tax rate for benefited individuals is 20%, instead of the withholding tax rate applicable otherwise (25-30%).

It should be noted that recently, a new inter-ministerial committee has reexamined the provisions of the Encouragement Law and its recommendations may trigger additional amendments.

The Expected Change to Digital Financial Activities

According to existing law, a foreign corporation's income is only taxable if it has been produced in Israel. If the foreign corporation is from a treaty country, the corporation must have a "permanent establishment" in Israel for its income to be taxable.

In light of the tremendous proliferation of financial activities via the internet and taking into account the OECD and G-20 efforts to address the international tax challenges of the digital economy, the ITA sought to redefine some of the key concepts of our tax regime, and published a draft of a "game changing" circular explaining its views regarding the taxation of income produced from services provided online. The draft expands the definition of a "permanent establishment" so that it might apply to a business if the core of its financial activity is via the internet, regardless of the physical location of its server. In determining whether such a corporation has a "permanent establishment", the ITA will consider indications such as the adequacy of the internet website to Israeli users (its language, style, currency, etc.); its use to connect Israeli consumers with Israeli suppliers; its popularity with Israeli consumers; whether the foreign corporation is exposed to business risks in Israel; and so forth.

Regarding VAT liability, a foreign corporation might be required to register as a licensed dealer and its transactions might be subject to VAT, if its internet activity has tight and direct ties to Israeli clients.

The draft, with its far-reaching applications, is now open for public comments, and may be amended adequately.

Tax Benefits to New Immigrants and Returning Residents

Israeli law defines an Israeli resident for tax purposes by using the "center of life" test which examines the individual's family, economic and social ties. The application of the test is assisted by two rebuttable presumptions regarding the number of days the individual has spent in Israel within a certain period of time. The law offers some benefits to new immigrants (who become Israeli tax residents for the first time) and veteran returning residents (who, in the past, were Israeli tax residents and became Israeli tax residents again, after being considered foreign tax residents for at least 10 consecutive years). For example, the benefiting individuals enjoy a 10 year tax and reporting exemption with respect to foreign source income and assets.

Taxation of Trusts

In 2006, Israel passed a comprehensive tax reform, which introduced an unprecedented tax on certain foreign trusts and foundations with Israeli settlors or beneficiaries. In 2014, the Israeli tax law was further redesigned in order to increase the scope of Israeli tax collection, in light of Israel's growing deficit. The government sought to increase tax collection from trusts and foundations, inter alia, by imposing tax liability on foreign trusts and foundations which were previously exempted.

According to the current law, a trust that has been settled by a foreign settlor, but has an Israeli beneficiary (except for Israeli charity institutions) are liable to Israeli taxation. Nevertheless, if all the trust's Israeli beneficiaries are "related by family" to the settlors, certain tax reliefs may apply. Tax reliefs are available to trusts and foundations where the settlors and beneficiaries are new immigrants or returning residents. Additionally, the 2014 reform imposed certain new reporting requirements. In general, the 2014 reform created a complex body of law, and, currently, there is a limited number of judicial rulings which serve to clarifying its provisions.

Voluntary Disclosure

On September 2014, the ITA launched a new voluntary disclosure program (the "New VDP"). The New VDP enables non-compliant taxpayers to come forward and arrange their reporting and tax obligations in exchange for the ITA's (in collaboration with the State Attorney) undertaking not to initiate any criminal proceedings against such taxpayers. The New VDP applies to any undisclosed passive or active income and assets, whether in Israel or abroad. However, the New VDP does not apply to income originating from illegal activities. The New VDP replaces previous programs and is in effect until the end of 2016.

The New VDP also includes two special application tracks which will be in effect until June 2016:

a) Anonymous applications – the application is submitted on an anonymous basis and the identity of the taxpayer is disclosed only after a tax agreement has been reached with the civil officer.
b) "Green Track" applicatios – if the total capital included in the application does not exceed NIS 2 million and the aggregate taxable income does not exceed NIS 0.5 million, the taxpayer may apply for this route.

Real Estate Reform

House prices in Israel have soared dramatically in recent years. The government took several steps to cool the market and reduce the cost of residential apartments, including canceling previously existing exemptions from land betterment tax and raising purchase tax brackets regarding purchases of residential apartments (particularly for foreign buyers or acquisitions of luxury residential apartments).

 

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Stellar Corporate & High Net Worth Client Base: Gornitzky is unarguably Israel's top tax law firm. Gornitzky is ranked by ALL legal guides worldwide as a Band One tax law firm, and its Partners are recognized leaders in this field. The team demonstrates its strength, working with a large number of the most high profile Israeli and overseas corporates entities with high end tax matters involving Israel. The firm represented over one third of Israel's largest and most influential business groups and 70 per cent of the top Israeli billionaires (according to Forbes). The legal team is particularly well known for its creative thinking and innovative domestic and international tax planning, including, in particular on multi-jurisdictional matters.

Gornitzky's Tax Practice: For more than 75 years, Gornitzky has been at the forefront of the Israeli tax practice and has been involved in many of the most complex tax cases in Israel. The firm provides all types of tax law advice, including domestic and global corporate tax, reorganizations and cross-border structuring, capital markets & financial products, taxation of high net worth individuals and trusts, transfer pricing, indirect tax, real estate tax and tax controversy and tax litigation, including white collar offenses. Gornitzky is one of a very short list of firms in Israel which practices in all of these sub-categories of tax. Gornitzky also has deep experience in leading negotiations with the Israel Tax Authority in all matters relating to tax issues. The lawyers represent clients before all judicial bodies, including the Supreme Court of Israel, and have won many breakthrough cases.

Pinhas Rubin: Chairman and Head of Gornitzky, who is considered by the Israeli financial press to be a "key position" holder and was listed therein as one of the people who will "open any door for you". The Marker Magazine has repeatedly identified him as one of the 100 most influential people in the Israeli economy, and leading international legal guides named him "a super lawyer" and "the best lawyer in Israel". Mr. Rubin is a reputable expert in numerous fields; particularly in tax, and trusts and estates. He has been regarded for many years now as Israel's top tax law expert.

Daniel Paserman: The head of Gornitzky's tax and fund formation practices. Mr. Paserman also serves as the secretary of STEP Israel (Society of Trust and Estate Practitioners). Mr. Paserman is involved in intricate corporate and individual tax planning - both domestic and cross-border. Mr. Paserman is active in a wide range of complex tax rulings, reorganizations and tax assessments. Mr. Paserman's broad experience also includes negotiations vis-à-vis the Israel Tax Authority and the litigation of tax disputes before various judicial bodies. In addition, Mr. Peserman specializes in taxation of trusts and estates and provides tax planning guidance for high net worth individuals.

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