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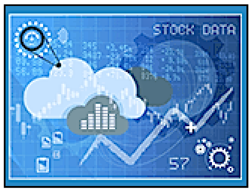
Tel Aviv Stock Exchange Pushes for Capital Investment Tax Break



By Matthew Kalman

The Tel Aviv Stock Exchange has hired a team of lobbyists to convince Israeli politicians that tax reform proposals which have languished for years will finally be approved.

The hires come after a decade in which local investors shunned Israel's capital markets, lured in part by tax benefits on real estate investments.

Snapshot

- Exchange lobbying for reduction of capital gains on share profits
- Tax breaks on real estate income sparked housing inflation, deterred investors

Ittai Ben Zeev, chief executive officer of the Tel Aviv Stock Exchange (TASE), wants to persuade legislators to reduce capital gains tax from its current level of 25 percent for private investors. Lowering the rate would help align stock investments with passive income from real estate, where the first 60,000 shekels ($17,422) is exempt, and landlords can opt to pay only 10 percent tax on additional income.

Been Zeev also legislators to consider tax-free individual savings accounts similar to those in the U.K., and to scrap a 3 percent surtax on those with annual incomes above 640,000 shekels, referred to as a wealth tax.

Ben Zeev's drive to increase private investors is part of an ambitious plan to almost triple daily trading volume over the next two years to more than $1 billion, underpinned by a planned $4.3 billion privatization of up to 15 government-owned companies by 2020. Tax reform will also make the exchange more attractive as it seeks an international buyer ahead of its planned IPO in 2019.

“The stock exchange is promoting by various means the idea of reducing capital gains tax. Lowering this tax will greatly help Israeli growth and the economy, by expanding the circle of investors on the stock exchange and by lowering housing prices,” a TASE spokesperson said by email March 4, explaining the need for “professional advisers” as the Knesset parliament debates the budget bill.

Need for Change

Israelis began paying capital gains on stock investments in 2003. The abolition of that tax exemption helped divert private investors to the real estate market, practitioners said.

The subsequent spiraling of housing prices, fueled in part by investor speculation, sparked major public protests. Finance Minister Moshe Kahlon has made the reduction of housing inflation a major priority. Housing prices have doubled in the last decade.

The reforms suggested by Ben Zeev aren't new. They were developed and championed by the former head of the Israel Securities Authority, Shmuel Hauser, but without success. Today the timing may be more auspicious, said Zvi Gabbay, former head of enforcement at the Israel Securities Authority and now head of capital markets at Barnea, Jaffa, Lande and Co. law firm in Tel Aviv.

“I support these changes and I think they are important in order to bring back investment in the capital markets, definitely vis-a-vis the prominence and dominance of investments in real estate in Israel,” Gabbay told Bloomberg Tax March 7. “I think there's no reason that there should be any tax preference to investment in real estate as opposed to capital markets.”

While taxing stocks and real estate investments similarly will not solve all the TASE's problems, “it is clearly evident that a lot of money is going into passive investments in real estate,” he said. “For the past decade it's been one of the favored investment vehicles.”

"There's absolutely no benefit in the Israeli economy from these types of activities and as long as from the tax perspective it makes sense for people to do that, they are going to. If they can change that, then that's a good thing," Gabbay said.

Some Challenges

While economists and practitioners agree that property speculation is a problem, exempting stock investments may not be the right solution, even if it will encourage more investment in stocks.

"From an economic perspective, policy-wise, tax legislation should not be used in order to influence such things. Tax should be indifferent. Taxpayers should invest based on the best economics and not because of certain tax advantages," said Daniel Paserman, partner and head of tax at Gornitzky and Co. law firm in Tel Aviv.

"I'm not sure that from a policy perspective this is something that the legislator should encourage," Paserman told Bloomberg Tax March 7.

"I'm skeptical. If you look at the economy, how important is it to have a strong and vibrant stock exchange? It's not just the taxes," Paserman said, citing regulatory burdens and other barriers to companies seeking to list on the Israeli exchange. "I'm not sure the taxes will be the only thing that will improve it."

Reducing capital gains on stock investments or canceling the wealth tax would add to a list of incentives that has rendered Israel's tax system "no longer progressive," said Yoseph M. Edrey, emeritus professor of law and tax policy at Haifa University.

"I don't know and never saw any serious research that assures that such a measure produces any kind of sustainable economic growth," Edrey said by email March 8. "Lowering tax rates entails either increasing the tax rate on labor or cutting the amount or quality of the public goods and services the government provides. Such measures may probably increase social gaps which lead—especially for the long run—to a slower economy."

"All the tax exemptions which are given to residential property contributed significantly to the market failure in this market and drove the prices up," he said. "I prefer that all the tax incentives be removed from our tax system."

"You don't improve the situation by adding more counter-distortions; instead, eliminate the current ones," he said.

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