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The case of Talmi v. Kfar Saba Tax Assessor

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In January 2018, a ruling in the case of Talmi v. Kfar Saba Tax Assessor (“Talmi case”) was published. This is the first ruling to address the interpretation and implementation of the New Residents Regime for new Israeli residents and veteran returning residents.

Tax Benefits to New and Returning Residents

- Amendment No. 168 to the Income Tax Ordinance (“ITO”) came into effect in 2008 and the purpose of the New Tax Resident Regime was to encourage Diaspora Jews and former Israelis to move to Israel by providing them with substantial tax benefits.
- Pursuant to the amendment above, the tax benefits grant a 10-year tax exemption on foreign source income that was produced or accrued abroad or stemmed from assets abroad, as well as an exemption from any tax reporting requirements with respect to foreign income and assets. Meaning that new Israeli residents or veteran returning residents are liable to tax and reporting in Israel during the said period only with respect to income derived from an Israeli source or asset.

The Talmi Case - Income Taxation of New and Returning Residents

- In the Talmi case, an individual resided in the UK for a period of 20 years and returned to Israel during 2007. Said individual was employed by EMC in the UK since 1994, and upon returning to Israel he carried on working at EMC UK (“Company”).
- In 2004, he was appointed as Sales Area Finance Manager, a position in which he oversaw different countries. In 2007, the individual moved back to Israel and carried on his position with the company as Sales Area Finance Manager of 5 countries: Israel, Turkey, Greece, Cyprus and Malta.
- Three points of controversy arose between the Israel Tax Authority (“ITA”) and the individual who claimed that:
 1. The income he received from the Company, following his return to Israel, was in connection with assets he developed for the Company during the time he resided outside of Israel and while being a UK resident. Thus, this income is a foreign income which should not be taxed in Israel during the 10 year period;
 2. The place where income was produced should be examined according to the remuneration attributed to each geographical territory for which he was responsible and not according to respective length of stay in the countries under his responsibility;

3. The date of his return to Israel was July 1st, 2007, upon which his new contract commenced. The Tax Assessor, however, claimed he returned to Israel on January 1st, 2007 due to the number of days he stayed in Israel during 2007.
- The court ruled on each of the issues above as follows:
 1. **Income derived from assets** - The Exemption should be interpreted in a broader sense. If the income being paid bears substantial affinity to foreign assets which were developed prior to the individual becoming an Israeli tax resident, said income should be considered income accrued from a foreign asset for all intents and purposes. The judge further elaborated and stated that due to the fact that legislation aims to encourage the return of returning residents to Israel whilst granting exemption on income accrued outside of Israel, the term “assets” should be broadly interpreted. Therefore, work methods, sale methods, financial products, various mechanisms and so forth, developed by an individual during the period he spent abroad, may be considered “assets” in order to be granted exemption. In the case at hand, it was determined that the existence of such assets was not proven due to lack of evidence by the Individual.
 2. **Income derived from employment** - the income should be allocated based on the actually locations in which the services were performed. In the absence of any other evidence on the individual’s part, adopting the formula set in the 2011 Income Tax Circular, according to which the allocation should be based on the business days spent by the individual in Israel and abroad, is reasonable and acceptable.
 3. **Date of commencement of residency** - The process of relocating the “Center of Life” of an individual to a different country does not take place “overnight”. It is a gradual process, maturing over a given period of time. This is relevant to both the commencement and the termination of a residency. When examining the days an individual spent during 2007, it can be noted that during the months of January till June, he spent only half the time in Israel. However, he spent most of his time in Israel starting the month of June. In addition, his employment contract began on July 1st, 2007. In light of the above, the court ruled that the individual’s date of return to Israel was July 1st, 2007.

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