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The First Court Case to Interpret the ten-Year Exemption Regime

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In January 2018, a ruling in the case of Talmi v. Kfar Saba Tax Assessor was published. This is the first court case to address the implementation and interpretation of the special residents tax regime for new Israeli residents and veteran returning residents.

Tax Benefits to New and Returning Residents

- In 2008, in honor of Israel's 60th Independence Day, a special alleviating tax regime was introduced, intended especially for new Israeli residents and veteran returning residents (applicable starting 2007). The special tax regime aims 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 ten-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 said period only with respect to income derived from an Israeli source or asset.

The Talmi Case - Taxation of New and Returning Residents

- In the Talmi case, an individual returned to Israel after residing in the UK for a period of 20 years and having been employed by EMC in the UK since 1994. On his return to Israel, he carried on working at EMC UK (**"the Company"**).
- In 2007, the individual moved back to Israel and carried on his position with the Company as Sales Area Finance Manager of five countries: Israel, Turkey, Greece, Cyprus and Malta.
- Three points of controversy arose between the Israel Tax Authority 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 Israel and while being a UK resident. Thus, this income was foreign income, which should not be taxed in Israel during the ten-year exemption period;
2. The location where the income was produced should be examined according to the remuneration attributed to each geographical territory for which he was responsible, and not according to the respective length of stay in the countries under his responsibility;

3. The date of his return to Israel was 1 July 2007, upon which his new contract commenced. The Tax Assessor, however, claimed he returned to Israel on 1 January 2007 due to the number of days he stayed in Israel during 2007.

- <u>The court ruled on each of the issues above, as follows:</u>

1. **Income derived from assets -** The Exemption should be interpreted in a broad sense. If the income being paid bears substantial affinity to foreign assets that 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 individuals to Israel while granting exemption on income accrued outside 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 they spent abroad, may be considered "foreign assets" in order to be granted exemption. In the case at hand, however, it was determined that the existence of such assets was not proven, due to lack of evidence presented by the Individual.
2. **Income derived from employment -** the income should be allocated based on the actual locations in which the services were provided. 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 fiscal residency. When examining the days the individual spent during 2007, it can be noted that, during January till June, he spent only half the time in Israel. However, he spent most of his time in Israel starting from June. In addition, his employment contract began on 1 July 2007. In light of the above, the court ruled that the individual's date of return to Israel was 1 July 2007.

Nearly a decade following the enactment of the special residents tax regime, the ruling in the Talmi case is the first to discuss the regime and its interpretation. The court has taken a broader stance, which is in keeping with the intention of the legislation. No doubt, this is good news for those individuals wishing to benefit from the provisions of this residents tax regime.

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