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Source: Daily Tax Report: News Archive > 2018 > April > 04/12/2018 > News > Israel: Observers Split on Israel's Tax Cut Pledge as U.S. Reform Bites

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Israel

Observers Split on Israel's Tax Cut Pledge as U.S. Reform Bites

By Matthew Kalman

Promised tax cuts in Israel are unlikely after lackluster revenue figures were released—though such a move would be politically popular and could help the country compete with the U.S., practitioners told Bloomberg Tax.

Finance Minister Moshe Kahlon said on March 21 he would cut taxes, though he didn't give specifics and said the decision would be based on the revenues for the first quarter of 2018. He has been silent since figures released on April 9, showing a $198 million surplus and rising spending, which may reduce the chances of a cut.

Snapshot

- Minister and central bank governor face off over tax cut pledge
- U.S. tax reform threatens tech investment in Israel

Meanwhile, the governor of the central bank is adamantly opposed to any cuts, arguing that surpluses should be funneled into education and infrastructure in order to ensure long-term growth.

"The results in terms of the revenues for the first quarter were only slightly above what was projected at the time the budget was planned," Bank of Israel Governor Karnit Flug said in response to a question from Bloomberg Tax at a news conference April 10. "I think there is a broad agreement among the professional staff also in the ministry of finance that it does not provide the basis for a reduction in taxes at the moment."

'No Reason'

Kahlon has already threatened not to extend Flug's tenure because of her resistance to some of his policies, but Flug isn't alone in opposing tax cuts.

"There is no reason," Daniel Paserman, partner and head of tax at Gornitzky and Co. law firm in Tel Aviv, said April 9. "People are speaking about a slowdown and prices falling in the real estate market. It's a bit early to start talking about tax cuts."

A tax cut now would be "too hasty," Yoseph M. Edrey, emeritus professor of law and tax policy at Haifa University said April 10. "First they have to do some research whether this tax cut will actually increase economic growth. I doubt it, not for the long term. Before they waste this revenue they should consider investing in infrastructure."

"The focus of the government's approach is way off," said Dan Ben-David, head of the Shoresh Institution for Socioeconomic Research at Tel Aviv University. The burden of tax distribution is "skewed" with half the population beneath the lowest income tax band and 90 percent of tax revenue paid by the top 20 percent of earners, he said in an April 9 email.

The next election must be held by November 2019, and a raft of corruption inquiries into the conduct of Prime Minister Benjamin Netanyahu has increased speculation that he might call an earlier ballot to secure his position ahead of a possible indictment.

Corporate Cut Needed

Still, the corporate tax cut in the U.S. requires an urgent response, practitioners said. The U.S. cut its corporate tax rate to 21 percent from 35 percent in the 2017 tax act (Pub. L. No. 115-97).

The U.S. corporate rate, compared to Israel's corporate rate of 23 percent, combined with Israel's 30 percent tax on dividends, could undermine the attractiveness of Israel's benefits to high-tech companies, said Yitzchak Chikorel, partner and head of international taxation at Deloitte in Tel Aviv.

"American companies may still use the skills in Israel but may change the business model, so the Israeli companies will be used as sub-contractors for R&D, but not as a whole business unit that also produces and sells. This may damage the Israeli economy," he said April 10.

Israel must aim “to be attractive to foreign, primarily US, companies, not as design centers, but as companies that will own the IP, and will produce and sell from Israel,” generating much more revenue for the country, he said.

Israel must cut its corporate rate or risk “migration of our high-tech industry to the U.S.,” said Gil Raveh, a partner at Raveh Haber and Co. law firm in Ramat Gan who advises foreign funds on Israeli investments. Raveh said he has already advised some companies to move abroad, while others never reached Israel in the first place.

The U.S. is now a ‘much better environment for doing business,” Raveh said.

“Overall they will have to reduce the tax rate. It's not the best for the people but it's necessary for the survival of the economy here,” he said. “If they want to encourage high-tech they need to encourage foreign investment and it's a very simple encouragement: just be like any other western country.”

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ISSN 1947-3923