August. 2016

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Proposed Tax Amendments for the 2017 - 2018 Budget

As part of the approval of Israel's budget for the years 2017-2018, the Israeli Tax Authority ("ITA") published an initial draft of its proposed legislative tax initiatives at the beginning of August. A revised draft was approved by the government cabinet on August 12, 2016, and it is expected that the legislative bill will be published within several weeks and brought to the approval of the Israeli parliament. As always, the proposed new budget includes a number of changes and reforms in the Israeli international tax regime. Below is a brief summary of the main suggested amendments (the "Amendment").

Tax Residency of Foreign Companies

Under Israeli tax law, a company is considered an "Israeli resident" for tax purposes if one of the following applies: (i) the company was incorporated in Israel, or (ii) the "control and management" of the company was carried out in Israel. However, there is no definition of the term "control and management" in the tax legislation and Israeli courts also tend to interpret it in accordance with the specific circumstances of each matter, and thus there are no clear and definitive rules to apply this criteria.

The Amendment offers a rebuttable presumption, according to which a company that was incorporated outside of Israel shall still be considered as an Israeli resident for tax purposes if the company is controlled by Israeli residents and the effective tax rate imposed on the company is 15% or less, and one of the following conditions takes place: (i) the company is a resident of a country that does not have a tax treaty with Israel; or (ii) the company is a resident of any other country that applies the territorial tax system, that is, it does not levy tax on income derived outside of it. In case such a foreign company does not consider itself an Israeli resident for tax purposes despite the existence of the presumption, it is still obliged to report its position in Israel.

"New Immigrants" and "Veteran Returning Residents"

Since 2007, "New Residents" and "Veteran Returning Residents" are exempt from Israeli tax and reporting with respect to foreign source income and assets during a period of 10 years, commencing on the date the individual became an Israeli tax resident.

In the initial legislative draft of the ITA it was suggested to abolish the exemption from reporting, starting January 1, 2017. In addition, it was suggested to cancel the possibility of extending the exemption period for an additional 10 years. At the end, this item was not approved by the cabinet and therefore the current legislation will remain unchanged.

Reporting Requirements of International Groups

Following Action 13 of the BEPS report (Guidance on the Implementation of Transfer Pricing Documentation and Country-by-Country Reporting), it is proposed in the Amendment to impose an obligation on companies that are part of an international group and operate in Israel to report to the Israeli tax authorities. The Amendment suggests issuing regulations that shall specify the documents and information that should be submitted, including, in certain circumstances, in respect of the foreign activities of the group in other jurisdictions.

CFC Rules

Controlled Foreign Corporation (CFC) rules, applicable in Israel today, provide, under certain conditions, that passive income of a foreign resident entity controlled by Israeli residents is considered as "deemed dividend" distributed to the Israeli shareholders. The current rules stipulate that income derived from interest, linkage differences, royalties and rent will not be considered passive income if they originate from a business.

The Amendment suggests setting a rebuttable presumption that income derived from interest, linkage differences, royalties and rent shall be regarded as passive income for CFC purposes, even if it was derived from a business.

Tax Exemption for Foreign Investors

Under Israeli tax law, the Minister of Finance has the authority to provide tax reliefs to foreign tax residents in case they cannot receive a tax credit in their home country. This authority is usually used in case of venture capital investments.

It is suggested in the Amendment to authorize the Minister of Finance to provide tax exemptions in these circumstances and thus simplify the current mechanism.

Encouragement of Capital Investments

The encouragement of Capital Law grants tax benefits to preferred enterprises, including reduced corporate tax rate of 16% and 9% (instead of 25%) and reduced withholding tax rate of 20% on dividends (instead of 25% or 30%).

The Amendment, which will apply to technology companies, includes new incentives intended, inter alia, to encourage foreign investors to invest in the Israeli high-tech industry. These incentives include, inter alia, a reduced corporate tax rate of 12% and 6%, and 4% withholding tax rate on dividends.

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