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Capital Losses - Tax Law

In recent years, many Israeli taxpayers have absorbed significant capital losses in capital markets in Israel and overseas. The tax laws in Israel allow the offsetting of losses against taxable gains; however, they set forth restrictions with respect to the manner of offsetting these losses. Below is a brief overview of the rules with respect to the offsetting of capital losses as set forth in Section 92 of the Israeli Income Tax Ordinance 5721-1961 (the "**Income Tax Ordinance**") (while there are additional rules that pertain, *inter alia*, to the offsetting of business (active) losses, this bulletin is limited to Section 92 of the Income Tax Ordinance and is not intended to exhaust the entire subject of offsetting losses).

The offsetting of capital losses that were created during the current tax year

The Income Tax Ordinance determines that a capital loss that is realized in the current tax year may be offset against a capital gain or betterment (land appreciation). If the capital loss is sustained from the sale of an asset outside of Israel, it will first be offset against a capital gain from an asset outside of Israel, and only thereafter, will it be offset against a capital gain of an asset in Israel.

In addition to the foregoing, a capital loss that is realized from the sale of securities may also be offset against interest income or dividend income that were received in respect of the said security or against interest income or dividend income that were received in respect of other securities, provided that the tax rate that applies to the interest or to the dividend shall not exceed the corporate tax rate (which currently stands at 26.5%, but which, effective from January 1, 2016, will be reduced to 25%).

The offsetting of capital losses that were created in previous years (carryforward losses)

A capital loss that was not offset in its entirety during a specific tax year will be offset in the following tax years against capital gains only, provided that the following terms and conditions shall be satisfied:

- A tax return was filed in the year in which the capital loss was created.
- A capital loss from the sale of an asset outside of Israel will first be offset against a capital gain from the sale of an asset outside of Israel.
- A carried forward capital loss must be offset against a capital gain that has been realized, even if the Israeli tax rate that applies to the said capital gain is lower than the regular rate of tax.
- A carried forward capital loss may be offset only against a capital gain or betterment (land appreciation), and not against interest or dividends.

Recommendations

In the event where there are both unrealized capital losses and income received from interest or dividends during the same tax year, it may be worthwhile to consider realizing the capital losses in order to offset the capital losses against such income. It is important to note that the realization of the capital loss must occur in the same tax year in which the income from interest or dividends was generated. Similarly, in the event of both an existing capital loss which has not been utilized (whether such capital loss has been carried-forward or is related to the current tax year) and unrealized capital gain, it may be worthwhile to consider realizing such capital gain so that the non-utilized capital loss may be used to offset such capital gain.

Furthermore, the foregoing shows that capital losses that were sustained in previous years (carryforward losses) may only be offset against capital gains that will be realized in the coming succeeding years (and not against income from interest or dividends). Therefore, in order to offset the carryforward capital losses, it is necessary to invest in assets that may generate capital gains (and not interest or dividends). Examples of such assets may include: shares, options, "short" transactions, funds which invest in securities (e.g. in interest bearing bonds), real estate, etc.

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