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COUNTRY

Doing Business in
Israel

Preface

This guide has been prepared by Baker Tilly HIGST, an independent member of Baker Tilly International. It is designed to provide information on a number of subjects important to those considering investing or doing business in Israel.

Baker Tilly International is the world's 8th largest accountancy and business advisory network by combined fee income, and is represented by 145 firms in 110 countries and 25,000 personnel worldwide. Its members are high quality, independent accountancy and business advisory firms, all of whom are committed to providing the best possible service to their clients, both in their own marketplace and across the world.

This guide is one of a series of country profiles compiled for use by Baker Tilly International member firms' clients and professional staff. Copies may be obtained from Baker Tilly HIGST or any of our international member firms.

Doing Business in Israel has been designed for the information of readers. Whilst every effort has been made to ensure accuracy, information contained in this guide may not be comprehensive and recipients should not act upon it without seeking professional advice. Facts and figures as presented are correct at the time of writing.

Up-to-date advice and general assistance on Israeli matters can be obtained from Baker Tilly HIGST; contact details can be found at the end of this guide.

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Geography

Location	Middle East, bordering the Mediterranean Sea, between Egypt and Lebanon
Area	Excluding the Gaza Strip and the West Bank, but including the Golan Heights, Israel has a land area of approximately 22,000km^2, of which two thirds is desert (the Negev)
Land boundaries	Lebanon on the north, Syria and Jordan on the east and Egypt on the south. It also borders the areas controlled by the Palestinian Authority
Coastline	273km
Climate	Temperate; hot and dry in southern and eastern desert areas
Terrain	The greater part of the country is either hilly or arid
Time zone	GMT +2

People

Population	7.1 million. The principal urban centres are Jerusalem (720,000), the metropolitan area of Tel Aviv (2.1 million) and Haifa (510,000)
Religion	76% Jews with the remaining 24% comprising Muslims, Druse, Christians and others
Language	Hebrew is the main language

Government

Country name	State of Israel (Israel)
Government type	Parliamentary democracy
Capital	Jerusalem
Administrative divisions	Six districts – Central, Haifa, Jerusalem, Northern, Southern, Tel Aviv
Political situation	Israel is a secular democracy where general elections are held every four years to elect 120 “Knesset” (Israeli parliament) members. Every Israeli citizen from the age of 18 is eligible to vote and can be elected from the age of 21. Elections are based on a system of proportional representation of party lists. The Israeli head of government is the prime minister who is the leader of the party that holds the most seats in the Knesset

Economy

GDP – per capita	US$26,600 (2007 est.)
GDP – real growth rate	5.3% (2007 est.)
Labour force	2.8 million
Unemployment	7.3% (2007 est.)
Currency (code)	The New Israeli Shekel (NIS), divided into 100 Agorot

2 Business Entities and Accounting

2.1 Companies

The Companies Law governs the activities of companies.

The most common form of business entity in Israel is a limited company with share capital.

A company can be either limited by share capital or by guarantee, or unlimited, in which case its members do not have any ceiling to their liability.

There are no requirements as to nationality or residency of shareholders and directors.

In order for a company to be considered incorporated, it must be registered with the Company Registrar at the Ministry of Justice. As well as certain other requirements, an incorporated company must have Articles of Association.

The Company Registrar usually accepts the English language.

2.1.1 Private companies

- 1 – 50 shareholders.
- Must file an annual report with the Registrar of Companies which includes information regarding shareholders and directors, but not financial statements.
- Annual financial statements, prepared according to generally accepted accounting principles and audited by professionally qualified auditors, must be presented at the shareholders' annual meeting.
- Shares and other securities should not be offered for sale to the public.
- There may be restrictions, upon shareholders agreement, on the transfer of company shares.

2.1.2 Public companies

- A minimum of seven shareholders, with no maximum limit.
- There are no restrictions on the transfer of company shares.
- If a public company's shares are traded on the Tel Aviv Stock Exchange (TASE), the company is required to:
  - Publish annual audited financial statements and quarterly unaudited (but CPA reviewed) financial statements
  - Appoint at least two directors (public directors) who do not have any business or other relationships with the company

- Appoint an audit committee comprising at least three directors, of whom two are public directors
- Appoint an internal auditor
- File annual and quarterly reports to the Registrar of Companies, the TASE and the Security Authority
- Make any offer to the public through a published prospectus
- Make an immediate announcement of any major event.

2.2 Branches

Foreign companies wishing to conduct business in Israel must be registered with the Registrar of Companies and provide the Memorandum and Articles of Association, a list of directors and other required information. Documents can be in either Hebrew or English.

2.3 Partnerships

The Partnership Ordinance governs the activities of partnerships. If a partnership is established for the purpose of conducting business in Israel, it can be either registered with the Registrar of Partnerships at the Ministry of Justice or remain unregistered. Registration requires, among others, submitting the partnership's name, activities, address, partners etc.

- A partnership can not comprise more than 20 partners.
- A partnership may be general or limited.
- A partnership does not have to file annual reports of any kind.

2.4 Audit and Accounting Requirements

All businesses must maintain proper books of accounts for taxation purposes and retain the accounting records and associated documents for at least seven years. All companies must have their accounts audited by a qualified accountant.

3 Finance and Investment

3.1 Exchange Controls

There are no exchange controls on inward or outward investment. Foreign currencies can be bought and sold freely and there are no restrictions on the maintenance of foreign currency bank accounts in Israel.

There are no limitations on the repatriation of profits from Israel.

3.2 Sources of Finance

3.2.1 Banking

Israel's central bank, the Bank of Israel, acts as banker to the government. It is responsible, inter-alia, for setting base interest rates through its monetary policy committee.

Overdrafts with fluctuating interest rates are the most commonly used facility for financing working capital or to fund seasonally affected business. Technically, overdrafts are repayable on demand.

Banks also offer short, medium or long-term loans. Repayment terms are negotiable; the rate of interest may be fixed or variable. To obtain bank finance the business will normally be required to provide adequate security, typically in the form of a fixed or floating charge over the business assets, as well as, in certain circumstances, personal guarantees from the owners.

In addition to these traditional services, banks offer various other financing arrangements through subsidiaries or affiliates. These include instalment credit, leasing, factoring and invoice discounting and mezzanine finance.

3.2.2 Stock exchanges and trading facilities

The TASE provides a market for shares and other securities issued by public companies and government bonds.

Trading in securities and raising capital from the public are regulated by the Securities Law, under which the Security Authority was established to protect the interest of investors.

To become and remain listed, a company must satisfy and abide by the extensive rules established by the TASE and the Security Authority, which is independent from the TASE.

3.2.3 Venture capital companies

For businesses that are not large enough to consider stock exchange entry but which require equity or mezzanine finance, venture capital companies can provide equity for start-ups, development, or management buy-outs.

Venture capital companies may also be a source of finance for a business that does not have sufficient security to borrow from a bank. However, they may require a higher return than a traditional bank.

3.3 Investment Incentives

Israel grants a wide range of incentives and benefits. Special emphasis is placed on high-tech companies and research and development (R&D) activities.

Israeli companies may also be eligible for benefits from international funds created as a result of co-operation agreements established between the Israeli and foreign governments, including Canada, USA and the EU.

Additionally, to promote weak economic regions within Israel, substantially higher benefits are granted in designated priority regions.

Further details can be obtained from Baker Tilly HIGST.

3.4 The Law to Prevent Money Laundering

Israel has enacted the money laundering law, which enables the country to take an active role in the international fight against money laundering.

3.4.1 No assistance to money launderers

The money laundering law imposes certain identification and reporting obligations on financial institutions, including banks, stock exchange members and money changers. These institutions are required to positively identify anyone, either a person or a corporation, requesting services such as the opening of an account, change of ownership of an account, or the execution of certain transactions.

3.4.2 No tipping off

The aforementioned institutions are also required to report certain transactions to the authority for the prevention of money laundering. These transactions fall into two categories:

- Transactions whose size exceeds defined amounts
- Unusual transactions – transactions which appear to be unusual in light of the information the institution possesses.

4 Employment Regulations and Social Security

4.1 Work Permits

For a non-resident to work in Israel a work permit or a status other than tourist is required.

Under the Law of Return, immigrants are entitled to permanent residence status or an A-1 visa which entitles the immigrant to a temporary resident status.

It is a prerequisite for other non-residents who wish to work in Israel to apply for a work permit (usually a B-1 visa). In order to obtain a work permit, Israeli employers must apply to the Ministry of Labour and, where applicable, to the Investment Centre.

4.2 Trade Unions and Worker Councils

There is no legal requirement for employers to recognise any trade union unless a majority of the work force votes in favour of such recognition. Agreements between employers and trade unions over pay and conditions are not binding by law and unions may not take industrial action without securing a majority vote in a secret ballot of their members.

There is no legal requirement for employees to be represented on the board of directors of companies.

4.3 Labour-related Costs

Labour-related costs can total 20%-30% of wages.

The Israeli employer's labour and social security costs include the following:

- National Insurance (social security) – employees pay up to 10.92% and employers 5.48% for a total of 16.4% of employees' salaries monthly. Cover includes unemployment insurance, maternity benefits, work injury, child allowances, pensions, medical care costs and reserve military duty compensation
- Paid vacation – employees are entitled to yearly paid vacations of 2-4 weeks depending on the length of employment. They are also entitled to a recreational allowance based on length of service

- Severance pay and pension funds – employees are entitled to severance pay on dismissal or on reaching retirement (67 for a male, 62 for a female) but not on voluntary resignation. However, some employers are required to pay severance pay on resignation under the terms of specific labour agreements. Severance pay amounts to one month's salary for every year of employment based on the last month's salary received. Many employers provide for this by monthly payments to a provident fund. In addition, most employers are required by labour agreements to make monthly payments to pension funds at the rate of 5% of salaries for employees' pension on retirement

- Sick leave – employees are entitled to paid sick leave

- Education fund – some employers make provision for the ongoing education of senior and academic employees by monthly payments, calculated at 5%-7.5% of employees' salaries, to a provident fund

- Reserve military duty – it is customary, although not required by law, that employers pay the difference between compensation received by employees for periods of reserve duty and the regular salary they would otherwise have received.

5 Taxation

5.1 Income Tax

5.1.1 Overview

Israeli residents are liable to income tax on their worldwide taxable income.

Companies not incorporated under Israeli law and not managed and controlled from Israel are liable to company tax on any trading profits derived from an Israeli branch or agency. Where there is a double tax treaty between Israel and the country in which such a company is based, its terms may modify the extent to which the company is liable to company tax.

Foreign companies are also liable to Israeli tax on other sources of income derived from Israel, subject again to the terms of any relevant double tax treaty.

A fiscal year is a full year starting on 1 January and ending on 31 December with a few exemptions, for example for subsidiaries of publicly traded foreign companies.

With a few exemptions, accounting should be conducted in Israeli currency.

The income tax legislation taken as a whole provides for the payment of taxes on income of a taxpayer from defined sources after deduction of disbursements and expenses incurred in the production of income and adjusted for inflationary conditions. It includes taxes on capital gains and provided for special benefits for investors in approved enterprises. The amount subject to taxation is known as taxable income.

5.1.2 Companies

The taxable income of Israeli companies is subject to a company tax of 26% (2009). Dividends paid to Israeli individuals or foreign residents (both individuals and companies) are subject to withholding taxes of 20% or 25% if the shareholder holds 10% of the shares or more. In the case of a valid tax treaty between Israel and another country, withholding taxes are determined in each treaty.

Company tax will reduce in 2010 to 25%.

Approved enterprises, foreign controlled companies and foreign investors may be subject to different and lower tax rates.

The domicile of a corporate entity is determined on the basis of two alternative criteria:

- If it is incorporated in Israel
- If the corporate entity is managed and controlled from Israel.

Special entities

Foreign professional company

A foreign company, most of whose income is derived from a “special profession” and at least 75% of whose control is directly or indirectly exercised by Israeli residents, is deemed to be a foreign professional company, subject to certain conditions. In this framework, such a company is deemed to be managed and controlled from Israel.

Income from a special profession, up to the part of the Israeli resident’s shareholders, is subject to Israeli corporate tax. Credit will be granted in respect of the foreign tax paid.

Controlled foreign corporation (CFC)

A foreign company is deemed to be a “foreign controlled company” if:

- The company’s shares, or rights thereto, are not listed for trade on the stock exchange. However, if said shares or rights are partly listed, less than 30% thereof are offered to the public

- Most of the company’s income or earnings during the tax year are derived from passive income. For this purpose, passive income constitutes income from sources including interest or linkage differentials, dividends, royalties, rental fees and proceeds from the sale of an asset not used by the company for its business

- The tax rate on passive income in foreign countries does not exceed 20%. For this purpose, the tax rate is defined as the amount of tax actually charged in respect of passive income during the tax year, divided by the total amount earned as passive income in that year

- More than 50% of one or more means of control in the company are exercised, directly or indirectly, by Israeli residents, or more than 40% of one or more means of control therein are exercised by Israeli residents who, jointly with a relative of one or more of the Israeli residents, own more than a 50% controlling interest in the company. Alternatively, an Israeli resident is entitled to prevent any major management decisions from being implemented in the company, including those relating to the distribution of dividends and/or liquidation of the company, whether control is held through shares or otherwise, including in trusts. Holdings, through control, are reviewed at the end of or on any date during the tax year, and also on any date during the following tax year.

Undistributed company profits are deemed to have been received by the controlling shareholders at the end of the tax year, including credit on the tax to which they would have been subject had the dividend actually been distributed.

Special provisions apply to holdings in a chain of companies and to dividends originating from taxable income at a rate exceeding 20%.

<u>Dividends received by a company domiciled in Israel from income generated or derived abroad</u>

The tax rate on taxable income of a corporate entity from dividends originating from income generated or derived outside Israel and dividends originating outside Israel is calculated according to one of the following:

- Default – corporate tax at the rate of 25%, with receipt of a tax credit in respect of tax withheld at source when distributing the dividend, in any amount up to 25%
- At the company's request or pursuant to the provisions of a relevant tax treaty, corporate tax on said income, with receipt of credit in respect of foreign tax withheld at source from the dividend and a credit in respect of foreign tax paid on income from which the dividend was distributed.

According to this alternative, the income is deemed to be a dividend income with the addition of tax paid on income from which the dividend was distributed. A company is entitled to benefit from such an indirect credit on dividend distribution provided it holds at least 25% of the controlling interest (as defined for the purpose of a foreign controlled company) in the foreign company. Additionally, an indirect tax credit is granted in respect of tax paid on the income of a "granddaughter" company – if the subsidiary, which is controlled at a rate of 25% or more, controls the "third tier company" at a rate of 50% or more.

Dividends paid, inter-alia, to Israeli individuals or foreign residents (both individuals and companies) are subject to a 20% withholding tax. However, dividends paid to substantial shareholders by private companies are subject to a withholding tax rate of 25%. This rate may be reduced according to a relevant tax treaty.

The tax rate on dividends paid to an individual is 20%; 25% if such individual was a significant shareholder (holding 10% and more of the distributing company) at the time of receiving the dividend or on any date in the 12 months preceding it. If paid to a company domiciled abroad – 20%; if such company was a significant shareholder on the date of receiving the dividend or on any date in the 12 months preceding it – 25%. Rates may be reduced according to the relevant tax treaty.

Dividends distributed from approved enterprises and/or to foreign investors may be subject to different tax rates.

5.1.3 Individuals

Tax rates are reducing gradually:

	Tax Rate	
Income (IN NIS)	**2009**	**2010**
50,040	10%	10%
50,041-89,040	18%	17%
89,041-133,680	27%	25%
133,681-238,680	32%	30%
238,681-413,400	34%	32%
413,401 and above	46%	44%

Tax brackets are adjusted periodically in accordance with changes of the Consumer Price Index (CPI).

There are exceptions to the above tax brackets, such as income from dividends, interest, rental of residential housing etc. There are also allowances for savings in pension funds, life insurance etc.

Individuals are entitled to personal tax credits against calculated tax; the amount of credits depends on personal status. Most of the credits are not available to non-residents; some are available only to new immigrants.

The lowest tax rate applies to personal exertion earnings. Incomes from passive sources are taxed at 10%-25%. Elderly individuals' income and income from real estate is taxed at a rate of 10% and higher.

Individuals' income from business is subject to the Adjustment for Inflation Law and losses may be carried forward.

Special income

Rental income

Income from rental fees of residential Israeli real estate is exempt from income tax up to a ceiling of NIS3,800 per month. The income tax liability on residential rental fees is calculated on the basis of one of the following:

- Rental income is calculated after deduction of expenses according to the regular tax bracket, or
- Tax is payable at the rate of 10% of rental income, without deducting expenses.

Rental income from outside Israel

An individual accruing income derived from rental of property outside Israel is entitled to pay tax on such income at the rate of 15% instead of the individual's graduated tax bracket to which the individual is subject if the said rental income does not reach the level of business income. However, the individual is not entitled to deduct expenses incurred (apart from depreciation expenses) in generating the rental income, including credit in respect of foreign tax paid abroad, from any amount paid.

An individual choosing to pay tax according to the graduated tax bracket to which they are subject rather than at a fixed rate of 15%, is entitled to deduct all expenses incurred in generating the rental income and to receive a credit on foreign taxes paid, subject to relevant legislation.

Benefits to new immigrants and returning residents

A "new immigrant" is an individual who acquires the status of an Israeli resident for the first time.

A "returning resident" is an individual who ceased to be an Israeli resident and lived outside Israel on a permanent basis during at least three consecutive years after ceasing to be an Israeli resident, subsequent to which they returned to Israel.

Business income

A new immigrant is exempt from income tax for four years from the date on which they became an Israeli resident in respect of business income earned from a business they had outside Israel during at least five years prior to becoming an Israeli resident for the first time.

Non-business income

A new immigrant is entitled to tax exemption for five years from the date on which they become an Israeli resident. The exemption includes income from interest, dividends, royalties, rental fees and pensions which do not constitute business income so long as the income is derived from assets which they possessed prior to becoming an Israeli resident and which remained in their possession after becoming an Israeli resident.

The exemption regarding non-business income is effective for a returning resident in respect of assets outside Israel acquired during their period of residence abroad after ceasing to be an Israeli resident.

Capital income

An individual who becomes an Israeli resident for the first time is exempt from capital gains tax on the disposal of an asset which they possessed outside Israel before becoming an Israeli resident if the asset is disposed of within ten years from the date on which they became an Israeli resident. The exemption is also effective for a returning resident in respect of assets outside Israel acquired during the period of their residence outside Israel.

Disposal of an asset after ten years is subject to tax pro rata to the period of holding the asset as of the end of ten years.

Benefits to foreign residents

Foreign residents are subject to the same tax rates as Israeli residents. However, if foreign currency was invested they may choose to calculate the capital gains in the original currency rather than in Israeli currency.

In addition, the inflationary gain on the sale of shares of an Israeli company or other assets purchased originally with foreign currency is exempt from tax if the calculation is based on changes in the specific exchange rates of the Israeli currency.

A foreign resident is exempt from capital gains tax from the sale of shares allocated to the foreign resident in 2003 and onward in a company designated as a R&D company as of the date of the allocation in consideration for monetary investment in the company.

A foreign resident is exempt from capital gains tax in respect of the sale of marketable securities if the capital gain is derived from a non Israeli permanent establishment of the foreign resident in Israel.

Under the recent tax reform, the above exemption also applies to securities purchased prior to being listed. These are taxed at sale only on that part of the capital gains developed up until their listing (capital gains of a notional sale at time of listing).

In addition, the tax reform allows for a specific exemption for residents of a treaty country, under certain conditions.

The exemption does not apply to the sale of the securities of a company, the majority of whose assets at the time of purchase and for the two years preceding the sale thereof were comprised of real estate and/or real estate companies.

5.1.4 Losses

Business losses may be offset against taxable income from any source in the same tax year. Business losses which cannot be offset in a tax year may be offset in succeeding years only against taxable income from business or a vocation (and not against non-trade income such as interest).

A loss from the leasing of property may not be offset against income from other sources and may only be offset in succeeding years against income from the same property.

Capital losses may only be offset against capital gains. Losses carried forward under the inflationary tax laws are linked to the CPI.

5.1.5 Filing tax returns

Taxpayers carrying on business are required to keep accounting records and file tax returns. The Commissioner of Taxes issues directives on the manner in which such records shall be kept.

Taxpayers who are employees and receive only salaries up to prescribed amounts and minor other income are not required to file annual tax returns. Under these circumstances tax is deducted in full at source.

Company tax returns must be audited and include a calculation of the taxable income. The tax return must also include audited financial statements, schedules of depreciation and calculations of adjustments for inflation.

Tax returns should be filed within 4-5 months of the end of the tax year (the tax year ends on 31 December annually) unless an extension has been applied for and granted.

5.1.6 Collection of taxes

Withholding taxes

To a large extent, the tax collection system is based on withholding of tax deducted at source from payments.

Advance tax payments

Companies and self-employed individuals must make monthly advance payments during the year. These payments are based on turnover or on tax liability for the last tax year for which an assessment has been issued. Withholding taxes may be offset against advance payments.

Monthly advance tax payments at the rate of 45% must also be made on certain non-deductible expenses such as excessive car, foreign travel or entertainment expenses.

Balance of tax

The balance of tax payable determined in the tax return after deducting the above advances and withholding taxes must be paid on filing the tax return. This balance is linked to increases in the CPI from the end of the tax year and bares interest at the rate of 4% per annum.

In the event of an overpayment, the balance accrues interest and linkage income on the same terms.

5.2 Capital Gains Tax

Gains from the sale of fixed and intangible assets (other then real estate) are taxed under the Income Tax Ordinance.

A capital gain is the excess of the sale proceeds of an asset over its depreciated cost. It consists of two parts:

- Inflationary gain – the part of the gain derived from linkage to the CPI
- Real gain – the difference between the total capital gain and the inflationary gain.

The real gain portion accrued since 1 January 2003 is subject to 20%-25% tax (until 31 December 2002 regular tax rates apply).

Inflationary gain accrued until 31 December 1993 is subject to 10% tax, and after that date is exempt.

Capital gains accrued until 1 January 2003 are subject to tax in accordance with previous tax rates. The disposal of an asset purchased prior to 1 January 2003 is implemented on a linear basis.

5.3 Transfer Pricing Regulations (Determining Market Price)

Transfer pricing regulations determine that in order to ascertain whether an international transaction conducted between related parties is at a fair market or arms length price, market research must be performed whereby the international transaction is compared to similar transactions by specific comparison methods. If the transaction is a one-off international transaction, duly approved as such by the assessing officer, no obligation to perform the market research applies.

5.3.1 Reporting requirements for an international transaction

Regulations oblige an assessee who is party to an international transaction to report in their annual tax return the execution of the international transaction, its actual conditions and price thereof, as well as the conditions and price of the transaction at fair market value, on the predetermined form.

In addition, at the request of the assessing officer, the assessee must present, within 60 days, a comprehensive report detailing the international transaction.

5.4 Taxation of Trusts

5.4.1 Foreign resident trust

Two main categories exist for a trust to be considered foreign resident, as opposed to Israeli resident, with different tax implications in each case:

- Foreign Resident Settlor Trust – a trust, whether irrevocable or not, is considered foreign resident if, during the relevant tax year, all of its settlors and beneficiaries are foreign residents, or at the time of its establishment and the relevant tax year all of its settlors are foreign residents, irrespective of the of the beneficiaries' residency. There are no tax liabilities when assets are transferred to such a trust. Assets transferred from the trust to the beneficiaries are considered as if transferred directly from the settlors to the beneficiaries and taxed accordingly (as such, there will be no tax liability for Israeli or foreign beneficiaries). The trust's income is taxable whether or not transferred to the beneficiaries as if it were the foreign settlors' income (even if the beneficiaries are Israeli residents). As such, income generated outside Israel is not taxable nor does it need to be reported in Israel

- Foreign Resident Beneficiary Trust – if a trust is established, inter-alia, by an Israeli resident as irrevocable and all the beneficiaries during the relevant tax year are identified foreign residents, the trust is considered a foreign resident beneficiary trust. Assets transferred to such a trust are considered as if transferred directly to the beneficiaries and taxed accordingly. There is no capital gains tax when the trust's assets are transferred to the beneficiaries. The trust's income is taxable whether or not transferred to the beneficiaries, as if it were the foreign beneficiaries' income. As such, income generated outside Israel is not taxable, nor does it need to be reported in Israel. If there is no locally generated income the trustee is required to sign a declaration to this effect for the tax authorities.

5.5 Participation Exemption for Israeli Holding Companies

Israeli holding companies are exempt from tax on dividends received from foreign subsidiaries and from capital gains tax upon the sale of such subsidiaries. Furthermore, Israeli holding companies are exempt, inter-alia, from tax on interest received on bank deposits in Israel and on income (interest, dividend and capital gains) from traded securities.

Foreign shareholders benefit from a reduced withholding tax on dividends to only 5%.

5.6 Value Added Tax (VAT)

VAT of 15.5% is payable on goods sold and services rendered and is collected from the buyer by the seller at the time of sale. These amounts, less VAT paid by the seller on their inputs, are paid monthly to the tax authorities. If the VAT on inputs exceeds amounts collected in any given period, the excess is refundable. VAT on inputs not related to the production of income and VAT on some expenses which are not tax deductible may not be claimed.

Financial institutions, such as banks and insurance companies, do not collect VAT on their services and may not claim VAT on inputs, but instead pay VAT of 16.5% on payroll costs and profits. Profits for VAT purposes are similar to taxable income for tax purposes before the offset of losses from previous years.

Non-profit organisations pay payroll tax of 7.5% plus employers tax of 4% on their payroll costs and may not set off VAT on inputs.

Importers pay 15.5% VAT on the value of goods for customs purposes when cleared.

Some transactions are zero-rated – a nil rate of tax is charged, but the business supplying the goods or services is, nevertheless, entitled to a refund of the VAT it has incurred on its purchases. Businesses making only zero-rated supplies are, therefore, in a position to obtain periodic refunds from the tax authorities.

Some services are exempt. Again, there is no VAT charged, but in contrast to the position on zero-rated supplies the supplier is not entitled to a refund of the VAT paid on purchases. Businesses that make exempt supplies in addition to either standard-rated or zero-rated supplies may be able to recover part of the VAT they incur on their purchases.

The principal categories of main goods and services classed as zero-rated or exempt are listed in Appendix 4.

VAT compliance regulations are strict and penalties are imposed for the late submission of periodic returns and for errors in returns. Businesses should avoid potential problems by implementing an efficient accounting system at an early stage.

5.7 Other Taxes

5.7.1 Custom duties

Certain goods imported to Israel are subject to custom duties. The rates vary and are usually based on cost, insurance and freight (CIF) value. Various agreements with the US, the European Community and EFTA reduce duties in comparison to imports from other countries.

5.7.2 Purchase tax

Certain goods sold in Israel are subject to purchase tax, payable by the Israeli manufacture or by the importer at the port of entry. Goods manufactured for export are exempt from such tax.

5.7.3 Stamp tax

Some contracts and documents are subject to stamp tax of 0.4% to 2% of the stated value.

5.7.4 Real estate taxes

Acquisition tax

Purchase of real estate is subject to an acquisition tax, to be paid by the buyer. The tax is based on the purchase price of the assets as follows:

Residential dwellings	0.5% – 5%
Other	3.5% – 5%

Certain transactions are entitled to reduced rates.

Betterment levy

A betterment levy at the rate of 50% is imposed on real estate if its value increased due to changes in building rights or upon re-zoning. The levy, linked to increases in price indices, is payable when a building permit is issued or upon the sale of the asset.

Land appreciation tax

Profits on the sale of real estate rights in Israel are subject to capital gain tax. The calculation of the tax is similar to that for other assets subject to capital gains tax.

Special rules apply to the sale of shares and rights in companies in which the major assets consist of real estate.

The sale of residential real estate by individuals is exempt from tax if certain terms are met.

The land appreciation tax was reduced from 7 November 2001 as follows:

- The tax on land betterment accrued prior to 7 November 2001 is at the marginal rate of up to 48% for individuals and 29% for companies (in 2007)
- The tax on land betterment accrued after 7 November 2001 is at the rate of 20% for individuals (in 2007 onward) and 25% for companies.

Sales tax

The following tax rate is applicable to the sale of real estate:

- Sale of land or title to a property purchased prior to 7 November 2001 – 2.5%
- Sale of land or title to a property purchased after 7 November 2001 – exempt from sales tax

- Sale of residential real estate held as inventory – exempt from tax
- The sales tax on real estate transactions executed after 7 November 2001 – tax-deductible from the seller's income.

Municipal tax

This annual tax, known as Arnona, is payable to the relevant local authority. The rate is based on the floor area and location of the property.

Appendix 1

Withholding Taxes on Dividend Payments

Dividend payments to overseas shareholders are generally subject to the deduction of withholding taxes between 20%-25%. The following table summarises the withholding tax rates according to existing tax treaties. The data listed is subject to exceptions, conditions etc according to the details of each treaty.

	%		%
Austria	25	Luxemburg	15/10/5
Belgium	15	Mexico	10/5
Byelorussia	10	The Netherlands	15/10/5
Brazil	15/10	Norway	25
Bulgaria	12.5/10	Philippines	15/10
Canada	15	Poland	10/5
China	10	Romania	15
Czech Republic	15/5	Russia	10
Denmark	25	Singapore	0
Finland	15/10/5	Slovakia	10/5
France	15/10/5	South Africa	25
Germany	25	South Korea	15/10/5
Greece	25	Spain	10
Hungary	15/5	Sweden	0
India	10	Switzerland	15/5
Ireland	10	Thailand	15/10
Italy	Up to 15	Turkey	10
Jamaica	22.5/15	Ukraine	15/10/5
Japan	15/5	US	25/15/12.5
Latvia	15/10/5	UK	15
Lithuania	15/10/5	Uzbekistan	10

Appendix 2

Withholding Taxes on Interest Payments

Interest payments to overseas lenders are generally subject to the deduction of withholding tax of 25%. The following table summarises the withholding tax rates according to existing tax treaties. The data listed is subject to exceptions, conditions etc according to the details of each treaty. Additionally, the Commissioner of Taxes may, under certain circumstances depending on the interest rate payable by the lender, reduce the tax rate.

	%		%
Austria	15	Luxemburg	10/5
Belgium	15	Mexico	10
Byelorussia	10/5/0	The Netherlands	15/10
Brazil	15/0	Norway	25
Bulgaria	10/5	Philippine	10/0
Canada	15	Poland	5
China	10/7	Romania	10/5
Czech Republic	10/0	Russia	10/0
Denmark	25	Singapore	15
Finland	10/0	Slovakia	10
France	10/5	South Africa	25
Germany	15/0	South Korea	10/7.5
Greece	10	Spain	10/5
Hungary	0	Sweden	25
India	10/0	Switzerland	10/5
Ireland	10/5	Thailand	15/10
Italy	10	Turkey	10/0
Jamaica	15/0	Ukraine	10/5
Japan	10	US	17.5/10
Latvia	10/5	UK	15
Lithuania	10	Uzbekistan	10

Appendix 3

Withholding Taxes on Royalty Payments

Royalty payments are generally subject to the deduction of withholding tax of 25%. The following table summarises the withholding tax rates according to existing tax treaties. The data listed is subject to exceptions, conditions etc according to the details of each treaty.

	%		%
Austria	10	Luxemburg	5
Belgium	10/0	Mexico	10
Byelorussia	10/5	The Netherlands	10/5
Brazil	15/10	Norway	10
Bulgaria	12.5	Philippine	Up to 15
Canada	15/0	Poland	10/5
China	10	Romania	10
Czech Republic	5	Russia	10
Denmark	10	Singapore	0
Finland	10	Slovakia	10
France	10	South Africa	1.5
Germany	5/0	South Korea	5/2
Greece	10	Spain	7/5
Hungary	0	Sweden	0
India	10	Switzerland	5
Ireland	10	Thailand	15/5
Italy	Up to 10	Turkey	10
Jamaica	10	Ukraine	10
Japan	10	US	15/10
Latvia	5	UK	15/0
Lithuania	10/5	Uzbekistan	10/5

Appendix 4

VAT: Zero-rating and Exemptions

The principle categories of goods and services classed as zero-rated or exempt are as follows:

Zero-rated	**Exempt**
Goods exported and sold for foreign currency.	Rent received on a private residence for a period of less than 25 years.
Receipts by a hotel for services rendered to tourists and paid for in foreign currency.	Proceeds from the sale of a building which is a rental building under the Encouragement of Capital Investment Law, leased for not less than ten years before the sale.
Receipts for services rendered outside Israel to a non-resident by a person whose main place of business is in Israel if payment is made in foreign currency.	Sale of an apartment which is not new by an individual who is not a dealer.
Receipts for services rendered in Israel for a non-resident. However, services are not exempt if they are provided in relation to assets situated in Israel unless they are for export and have been exported.	The import of personal effects by a new immigrant.
Sale of an intangible asset to a non-resident.	Exported goods, re-imported.
Goods sold by a duty free shop.	Income from deposits with financial institutions.

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