

WHAT IS THE FUTURE FOR NEW IMMIGRANT BENEFITS?

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Tags

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Reporting Requirements

In 2008, the Knesset Committee for Immigration Absorption passed Amendment 168 to the Income Tax Ordinance [New Version] 5721-1961, granting a favorable tax regime to new immigrants and returning residents to Israel (the “New Immigrant Benefits”). The move to Israel is often referred to as *Alya*. The purpose of the reform was to encourage immigration to Israel from wealthy countries while providing new immigrants with a period of time to organize tax structures in an efficient way.

The New Immigrant Benefits rules were adopted with the support of the Israeli Tax Authority. The rules became effective for new immigrants who arrive in Israel on or after January 1, 2007.

TAX INCENTIVES

Liberalization of Israel’s Economy

Promoting immigration by granting favorable financial and tax treatments in a country that was built through immigration was not an obvious matter. It reflects the liberalization of the Israeli economy.

The first step occurred in May 1998, when a major change took place in the Israeli foreign currency regulations. The new regulations allowed Israeli residents to have foreign currency accounts outside of Israel and to buy, sell, and own property abroad. The reform was revolutionary because at this time, Israeli residents were taxed only on Israeli income. This changed on July 24, 2002, when the Knesset approved an amendment to the Income Tax Ordinance abolishing the territorial principle of taxation under which the tax base was limited to income accrued or received in Israel. The new legislation introduced the principle of personal global taxation, meaning that Israeli residents were subject to tax on worldwide income.

In the same period, New Immigrant Benefits were introduced for a period of four to five years depending on the nature of the income. The new rules were effective from January 1, 2003. Foreign business income was exempt for four years while non-business income such as passive income was exempt for five years. In addition, new immigrants were exempt from capital gains tax on the sale of assets located outside Israel that were in their possession prior to arrival. The exemption lasted for a period of ten years from arrival.

Taxation of Israeli Residents

Determining the point when Israeli tax residence begins is not an easy task. In many instances, individuals spend significant time in Israel where they may own a leisure home or where family members reside. It is not uncommon for these persons to

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“Determining the point when Israeli tax residence begins is not an easy task. In many instances, individuals spend significant time in Israel where they may own a leisure home or where family members reside.”

create professional ties with Israel before deciding to leave their home countries. These visits and ties grow incrementally over a period of many years and may be quite strong prior to the time when a more formal transfer of residence occurs.

Israeli tax residence is based on an individual’s personal facts and circumstances. An individual is considered an Israeli resident for income tax purposes if the center of life is in Israel. Case law lists a number of indicators used to determine the individual’s center of life:

- The place of the individual’s permanent house
- The place where the individual and his or her family live
- The individual’s regular or permanent place of business or employment
- The individual’s place of vital and active economic interests
- The place in which the individual is active with regard to various organizations, unions, or institutes¹

These are “touchy/feely” standards and no single factor, by itself, is controlling in all circumstances.

In addition to the above tests, an individual is presumed to be an Israeli resident if presence in Israel exceeds a specific number of days. This is known as the “days test.”

Currently, Israeli residents are subject to personal income tax at progressive rates of up to 48%. In addition, a special tax of 2% is imposed on any income above NIS 800,000. Passive income such as financial portfolio income is taxed at reduced flat rates, usually 25% to 27%.

BENEFITS PROVIDED UNDER THE 2008 REGIME

A Broad Definition of New Immigrants

The New Immigrants Benefits regime applies to two main categories of individuals:

- A “first time Israeli resident,” *i.e.*, an individual that becomes an Israeli resident the first time
- A “veteran returning resident,” *i.e.*, a former Israeli resident who returns to Israel after a period of at least ten years of foreign residence

First time Israeli residents and veteran returning residents will be referred to as “New Immigrants.” New rules apply to these individuals. At the same time, scaled-back tax benefits apply to individuals who were Israeli residents at one time and have returned to Israel after being abroad for between six and ten years. These persons are referred to as “Regular Returning Residents.”

¹ However, such test should not be considered as being definitive.

Main Features of the New Immigrant Benefits

The main features of the New Immigrant Benefits are as follows:

- *Exemption for Foreign Source Income and Capital Gains:* New Immigrants are exempt from tax on foreign-source income for a period of ten years. This exemption applies to earned income and passive income. Capital gains arising from non-Israeli assets or shares in an Israeli company acquired while the individual was a foreign resident are exempt from Israeli capital gains tax for the same ten-year period. Following the exemption period, the portion of any gain derived from a sale of the assets continues to be exempt from tax to the extent attributable to the holding period, beginning on the date of acquisition and running to the end of the ten-year exemption period. The exemption is calculated on a linear basis so that the days in the exempt holding period are divided by the total days in the entire holding period; the resulting percentage is applied to the gain.
- *An Exemption on Reporting Foreign Source Income:* New Immigrants are exempt from reporting their non-Israeli-source income, gains, and assets.
- *Exemptions Provided to Companies Held by the New Immigrant:* Foreign companies, held by New Immigrants will not be considered managed and controlled from Israel merely because of the immigration of a New Immigrant owner to Israel. Again, this benefit lasts for a period of ten years from immigration. In the same way, New Immigrants are not considered Israeli residents in respect of the C.F.C. legislation during the exemption period. Lastly, New Immigrants are not subject to the Foreign Occupation Company regime.
- *Entitlement to an Adjustment Period Election:* Within 90 days from the date of arrival, a New Immigrant can elect to defer Israeli tax residence for a period of one year from the actual arrival date in Israel. In such circumstances, he or she will not be issued a residency certificate from the Israeli Tax Authorities.

These exemptions apply only to income generated abroad. As a consequence, if a New Immigrant works from Israel for a foreign company, the Israeli activity may likely create a permanent establishment in Israel for the company. The profits allocated to the permanent establishment will be taxable in Israel. In addition, a New Immigrant will be subject to tax on the working days in Israel.

Main Features of Limited Benefits to Regular Returning Residents

Regular Returning Residents are tax exempt on income generated by assets purchased during the period of foreign residency. These include

- a five-year exemption for (i) passive income derived from assets acquired during the nonresident period, (ii) interest and dividend income derived from “preferred securities,” which are securities traded on foreign exchanges that have been purchased during the nonresident period, and (iii) income from other securities that have been purchased with proceeds of an exempt sale when the proceeds are placed in a “closed bank account;” and
- a ten-year exemption for capital gains from the same assets, provided that they do not represent a right to an Israeli asset.

CERTAIN ADVERSE CONSEQUENCES

While the New Immigrant Benefits generally provides attractive tax rules, certain adverse consequences may result in a specific set of circumstances.

Entitlement to the Treaty Benefits

It is not unusual to encounter tax treaties that define a resident of a treaty jurisdiction as a person who is subject to tax on worldwide income by that jurisdiction. Examples include income tax treaties between Israel and Switzerland, Germany,² Spain, and France. In such circumstances, the tax treaty does not apply to a New Immigrant who benefits from the New Immigrant Benefits. In some circumstances, the withholding tax in these countries can exceed the Israeli tax imposed on residents, generally.

Residency Certificate for New Immigrants

In many situations, tax authorities require that a residence certificate be furnished prior to the time that a withholding agent makes payment to a resident of a treaty jurisdiction. Without the certificate, tax must be withheld as if the treaty does not exist. In other situations, financial institutions demand residence certificates for compliance requirements under applicable know-your-customer rules or anti-money-laundering rules.

The Israeli Tax Authority has a strict policy regarding the issuance of residence certificates for New Immigrants. The reason is that the Israeli Tax Authority wishes to avoid situations where an individual takes advantage of the New Immigrants Benefits without actually transferring the center of life to Israel. Strong supporting evidence is required indicating presence in Israel for at least 143 days over a period of years before a residence certificate will be issued.

INFORMATION REPORTING – FLASHPOINT

Although tax exemption regimes exist in other countries, the New Immigrant Benefits has been repeatedly criticized for the information reporting exemption that is provided to New Immigrants. Both the O.E.C.D. and Israel's trading partners insist that Israel should comply with the current international trend towards transparency and exchange of information. The O.E.C.D.'s Global Forum on Transparency and Exchange of Information for Tax Purposes recently underlined that the reporting exemptions granted to New Immigrants are not compatible with current O.E.C.D. objectives.

Accordingly, it is expected that Israel will amend the Income Tax Ordinance as a result of the pressure for information transparency. In that regard, the Israeli Tax Authority and the Israeli government have suggested eliminating the ten-year reporting exemption on foreign income and gains that is currently available to New Immigrants. While these initiatives have not yet succeeded, many believe that it is only a matter of time until the exemption from reporting is eliminated. Note that even if information reporting is required, the tax exemption regime will remain in effect.



² See the May 21, 2014 version, not yet ratified.