MEMORANDUM

RE: **Ten Years After in Israel –**
Expiration of new immigrant / returning resident tax exemptions

FROM: **George Rosenberg and Itamar Hauser**

DATE: **December 31, 2019**

It is now slightly more than 10 years after the Israeli Ministry of Finance and the Israeli Tax Authority, in celebration of the 60th anniversary of the State of Israel, introduced a new set of tax benefits to encourage new and returning residents (who were non-residents for at least ten years prior returning[1]) to move to Israel and enjoy the benefits of an exemption from taxation and reporting on all income not sourced in Israel ("**the Benefits**") for a period of ten years, beginning on the date the individual became a resident, or returning resident, as the case may be ("**the Benefits Period**").

The Benefits were introduced in a form of an amendment to the Israeli tax law, the Income Tax Ordinance, which was published in September 2009 and applied retroactively as of January 1, 2007. As a result, people that immigrated/returned to Israel in the years 2007-2009 now have reached / are reaching the end of the Benefits Period.

Following is a **list of matters that might need to be taken into account by an individual, new or returning resident** ("**Exemptee**"), who is approaching the end of the ten-year Benefits Period:

1. <u>Taxation and reporting – general</u>

- Routinely, after the 10-year Period expires, the individual must start filing annual tax returns and various notices with the Israeli Tax Authority ("**the ITA**") in respect of his worldwide income and assets – i.e. both ordinary income and capital gains.
- The annual tax return must generally be filed by April 30th and include the income generated in the previous year. If the Benefits Period expired in the middle of the tax year, a tax return must be filed with respect to the relevant part of that year.
- Where a trust or a foundation was eligible to enjoy the Benefits to which its creator and/or beneficiary were entitled as new/returning residents, the trustee, or the foundation, as the case may be, would be required to file an annual tax return with the ITA and pay the tax due on the income of the trust/foundation.
- While all the above filings generally include only realized gains and earned income, nevertheless, periodically and more or less at random, usually once every few years, the ITA may approach the

[1] Such a returning resident is referred to in the Income Tax Ordinance as a Veteran Returning Resident. Returning resident who has been non-resident for less than ten years but more than 6 ("Returning Resident") is also entitled to tax benefits but on a reduced basis and subject to some restrictions. As this memorandum deals with Veteran Returning Residents only, any reference to "Returning Resident" is to "Veteran Returning Resident".

taxpayer and require the filing of a wealth (asset) declaration in respect of all worldwide assets and their value.

2. Some Practical Suggestions

- In respect of portfolio assets, in general, it is advisable to reduce assets which generate interest, dividends or royalties since these will become fully taxable as soon as the Benefits Period expires.
- In respect of assets which have earned unrealized capital gains, the sale of these assets should be considered prior to the expiry of the Benefits Period at a full exemption from capital gains tax (with or without subsequent re-purchase), although, unlike the case of ordinary income (foregoing bullet point), this exemption does not expire at the end of the ten years but continues to apply on a reducing basis to a certain part of the capital gain, arrived at by dividing the period from acquisition of the asset to the expiry of the ten years by the period from the acquisition to the sale of the asset.
- The purchase of a life insurance policy with a large saving component ("insurance wrapper") prior to the expiry of the ten years will result in postponing the tax on the income earned in the saving component, to the date the policy is paid in part or in whole.

3. Gifts

- While there is no gift tax in Israel, nevertheless, in principle, gifts may be subject to capital gains tax since such tax is due generally on any disposition of an asset.
- However, cash gifts, and gifts of moveable assets (e.g. securities) to Israeli resident relatives and other resident individuals given in good faith, are exempt from capital gains tax. Such exemption does not apply if the donee is a non-resident.
- Gifts of real estate between parents and descendants are exempt of capital gains tax, but are still subject to purchase tax, albeit at a reduced rate.

4. Inheritance

- There is no inheritance tax in Israel, and there are no forced heirship rules.
- When an Israeli resident inherits assets and disposes of them at a later stage, the calculation of the capital gains tax on the disposition will be based on the original historic purchase price of the assets and not on the value at time of the death of the deceased or at the time the assets were distributed to the heirs.
- In cases where the assets disposed by an heir are foreign assets, inherited from a non-resident, the ITA allows for a certain step-up procedure which will set the value of the assets on the date in which the assets were inherited.

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5. Consequences regarding control of non-resident companies

The Income Tax Ordinance provides that where a business of a foreign (non-resident) company is managed and controlled in Israel, such company is deemed tax resident in Israel and therefore subject to tax in Israel in the same manner as any ordinary Israeli company doing business in Israel, **unless the business is managed and controlled by a new immigrant or veteran returning resident and all the activities of the company are carried out outside of Israel.** Thus, an Exemptee may sit in his home or office in Israel and direct the worldwide (outside of Israel) activities of his foreign business without the business being subject to tax in Israel.

Similarly to all the other Benefits, this Benefit, expires at the end of the ten years. One needs to plan in ample time, therefore, the substitution of a non-resident director in place of the Exemptee, if the Exemptee served as director during the Benefits Period, and the channeling of all management and control mechanism through non-residents, in order to make sure that the non-resident company will not be deemed resident and therefore taxable.

Further considerations:

Emigration consequences

Emigrating from Israel creates an exposure to exit tax. Under the Income Tax Ordinance, a person who leaves Israel and ceases to be a resident is deemed to have sold all his assets on the day prior to the day on which he ceases to be resident.[2] As such he is subject to capital gains tax, but the payment of the tax may be postponed until the assets are actually sold.

If an Exemptee ceases to be a resident prior to the expiry of the Benefits Period, he will be entitled to enjoy an exemption of the said capital gains tax in respect of all his assets situated outside of Israel since the deemed sale took place during the Benefits Period. If the Exemptee ceases to be a resident after the expiry of the Benefits Period, and becomes tax resident in a country, in which an asset owned by the Exemptee is situated and which has entered into a tax treaty with Israel, then the capital gains tax due may be subject to the provisions of such treaty upon the actual sale of the assets.

[2] The Income Tax Ordinance and jurisprudence provide for complex presumptions and rules when a person is deemed to have ceased to be an Israeli resident and became a non-resident.

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Exchange of information

In the course of the last few years Israel became a party to the various international multilateral agreements that enable tax authorities around the world to share and exchange information. Together with its wide network of tax treaties, the ITA may send and receive financial information on assets held by Israeli residents on three different routes: (i) spontaneously; (ii) upon request; (iii) automatically. Some of these exchanges have already began within the frameworks of FATCA (USA – as of 2014) and the CRS (EU – as of 2018).

For any questions or comments, please don't hesitate to contact us.

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