

MEMORANDUM

FROM: George Rosenberg / Inbal Faibish
RE: Increased tax benefits for new immigrants and returning residents
DATE: June 24, 2009

On September 9th, 2008 the Israeli Parliament (the "Knesset") adopted an important amendment of the Income Tax Ordinance ("the Amendment") regarding the taxation of New Residents and Returning Residents. The Amendment entered into force upon its publication in the Official Gazette ("Rashumot"), on September 16th, 2008, and includes the following benefits:

- New Residents will enjoy tax and reporting exemptions on every type of income, both ordinary and capital gains¹, which is not sourced in Israel, for a period of 10 years.
- In their first year as residents, New Residents will be entitled to a tax-free "adaptation year".
- A non-resident company, which is controlled by a New Resident, will not be deemed resident even if its business is managed and controlled by the New Resident from Israel, and consequently any income derived from such company by the New Resident, during his first ten years of residence in Israel, will be tax exempt.
- Returning Residents, who have lived out of Israel for over 10 years, will be entitled to the same benefits as New Residents above. Transitionally, Returning Residents who have returned to Israel after January 2007 or will return until December 31, 2009 will be eligible for the same benefits even if they were non-residents for only five years prior to their return.
- Returning Residents who returned before January 1 2007, after having been non-residents for at least three years, will continue to enjoy the current five-year exemption from certain passive income and the current ten-year exemption from capital gains.² Returning Residents who will return from January 1, 2010 onwards, after having been non-residents for at least six years, but less than ten, will be eligible for the same benefits as those who returned before January 1, 2007.

Finally, in order to avoid the inherent uncertainty in the definition of "non-resident" (foreign resident), the definition has been eased so that any Israeli resident who has resided abroad for

¹ The ten-year exemption re capital gains already exists under current law; it does not terminate at the end of the ten-years, but continues on a proportionately reduced basis calculated on the proportion between the period from the end of the ten years to date of sale, and the period from the date of acquisition to the date of sale.

² See footnote 1.

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four consecutive years, will be deemed non-resident from the first day that he resided abroad, even if he is able to satisfy the test of having shifted the centre of his life abroad only for the third and fourth year.

Following is a comparison between the current situation and the new law:

Subject	Current situation	Amendment
Tax exemption on foreign passive income (not including capital gains)	New Residents and Returning Residents (3-year absence) enjoy five-year exemption	10-year exemption, both for New Residents and Returning Residents (10-year absence)
Tax exemption on foreign business/vocational/salaried income	New Residents enjoy 4-year exemption from business income only, provided the business was owned by the new resident at least five years prior to his arrival to Israel	10-year exemption, both to New Residents and Returning Residents on all three types of income, without the existing restrictions.
Tax exemption on capital gains	10-year exemption, both for New Residents and Returning Residents (3-year absence)	10-year exemption, both for New Residents and Returning Residents (6-year absence)
Companies controlled by a New Resident or a Returning Resident	No legislation	In the first 10 years the company will not be subject to the "management and control" residence test, and its income will be exempt.
Adaptation period	No legislation	First year from the date of immigration to be a tax-exempt "adaptation period", for both New Residents and Returning Residents
Reporting duties	Exemptions apply under certain conditions	No reporting obligations, for both New Residents and Returning Residents

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On March 2, 2009, the Tax Authority published a Circular, which includes specific instructions in connection with Adjustment Year mentioned above.

According to the Amendment, whoever elects for the Adjustment Year must notify of his election, within 90 days as of his arrival or return to Israel by a form determined by the Tax Authority. The Circular clarifies that a New Immigrant that arrived in Israel from January 1st, 2007 and until December 31st, 2008 may notify of his election until March 31, 2009, and such notice shall be deemed as having been submitted on time. The election for an Adjustment Year may not be revoked.

The Circular also set forth conditions under which the Individual Beneficiary shall be deemed as having arrived in Israel, including criteria to determine the Day of arrival to Israel.

According to the Circular, during the Adjustment Year, New Immigrant will be subject to the following benefits:

- In the event that the New Immigrant shall leave Israel during the Adjustment Year, he will be deemed in fact as a person who did not immigrate or return to Israel in the first place.
- A New Immigrant who opted for the Adjustment Year and left Israel during the course of such year will not be subject to an Exit Tax.³
- The New Immigrant's holdings in a body of persons shall be deemed as the holdings of a foreign resident, and will therefore not be subject to the Israeli Controlled Foreign Corporations Rules.⁴
- The New Immigrant will be entitled to the exemptions granted to a foreign resident, e.g., exemption on capital gains and exemptions in interest income from bank deposits.⁵

The Circular emphasizes, however, that during the Adjustment Year the New Immigrant will not be entitled to receive confirmation of his status as an Israeli resident and, accordingly, the provisions of the Avoidance of Double Taxation Treaties applicable to Israeli residents shall

³ Section 100A of the Ordinance

⁴ Section 75B of the Ordinance, for further details see: Section 3.2.10 – “Controlled Foreign Corporations”

⁵ Section 97(b1) – (b3) of the Ordinance.

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not apply to him.⁶ The New Immigrant will also not be entitled to receive credit points granted to Israeli residents.⁷

*

This memorandum is by way of a general guide only and should not be regarded as a legal opinion, or relied upon without seeking legal advice.

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⁶ for further details see: Section 3.2.9 – “Tax Treaties”

⁷ for further details see: Section 3.2.1 – “Taxation of Residents”

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