Israel's Tax benefits for International activities

Kaplex group appreciates your interest in Israel as a base for international activity. On January 1st 2006 a new amendment to Israel's tax laws will become effective. The ultimate goal of the amendment is to create a tax environment which attracts foreign investors as well as encourages the use of Israel as a base for international activities. The new tax law offers you and your clients several unique tax benefits. The following is a brief summary of the main benefits.

1. Foreign resident settlor trust

A foreign resident settlor trust is a trust that at the time of its formation and during the tax year all its settlors are foreign residents (regardless of the beneficiaries' residency) or that during the tax year all its settlors and all its beneficiaries are foreign residents. Whether or not the trust is irrevocable, a foreign resident settlor trust will be considered as a foreign resident. The assets held by the trustee will be viewed as assets that are held by an individual foreign resident and the trust's income will be viewed as the income of an individual foreign resident. The meaning of the law is that if the trust profits are not derived from sources in Israel, they are not taxable in Israel and there are no reporting duties in Israel. Furthermore, not only is income from rental, interest, dividend, capital gains and business profits outside Israel not taxable and not only does it not involve reporting duties by the Israeli trustee, also interest income within Israel and capital gains can, in certain cases, enjoy exemptions because it is seen as interest income or capital gains of a foreign resident. This kind of trust will also enjoy relevant tax relief set by the tax treaty between the settlor's country of residence and Israel.

2. <u>Underlying Company In Israel</u>

One of the major changes of the trust taxation law is the ability to establish an underlying company in Israel or abroad.

An "underlying company" is defined as a "group of persons" holding the trust's assets, for the trustee, directly or indirectly. This group can be a typical company, foundation, partnership etc. The new law provides that this corporation is now regarded as a "flow through entity". This means that the Israeli tax authority ignores the company and treats the assets and the income as if they were held directly by the trustee.

As previously noted a "foreign settlor trust" is not subject to tax and does not have to file reports on income derived from outside Israel, even if the trustee is an Israeli resident. The concept of an underlying company is simple and advantageous in constructing the best trust arrangement possible.

3. <u>Pre ruling</u>

A new concept in Israel. The law provides that any Israeli or foreign resident can file a request for a pre ruling decision. It is possible to negotiate with the Israeli tax authority and receive a ruling for almost any kind of activity. This provides the foreign resident with certainty about the tax consequences of his activities.

4. <u>Israel tax treaties</u>

Israel is a party to 40 double taxation treaties. A foreign investor who takes advantage of double taxation treaties can often withdraw profits earned in Israel under favorable tax treatment. Where a taxpayer is taxable both in Israel and abroad with respect to the same income, double taxation relief may be available either in accordance with a bilateral tax treaty (convention) or, in certain cases, unilaterally. Most of Israel's tax treaties are based on the model treaty of the OECD and they provide certainty that no double taxation will occur and no discrimination is possible. In addition, the tax treaties provide a wide range of tax planning possibilities on behalf of clients.

5. **Participation exemption**

The Israeli participation exemption law is a unique and progressive law. The law enables a foreign resident to establish in Israel an exempt business center for international activities in the form of an Israeli Holding Company. An Israeli Holding Company is an Israeli company that fulfills several conditions. One of the major conditions is that the company's investment in foreign subsidiaries will be at least 50,000,000 N.I.S (approximately 12,000,000 U.S.D).

When the IHC distributes dividends to the foreign share holder the dividend is subject to only 5% tax.

6. **Exemption from capital gains**

Foreign residents will, in principle, be exempt from taxes on income from the following sources:

A. Passive investments in Israeli banks.

B. Capital gains from stock market equities.

C. Capital gains derived from the sale of securities of a private Israeli company bought between July 1st 2005 and December 31st 2008.

7. **Other benefits**

Israel has tax rules regarding partnerships, companies, real estate investment trusts and more. Each can be used to optimize your clients' activities. If further research is required with respect to the options available to your client or, if you have any questions regarding the above, please do not hesitate to contact us.

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