The new state of Israel, established by immigrants, views itself as the home of every Jew regardless of his current place of residence. This is the logic behind the important Israeli law of return. As a result of this perception, certain laws in Israel are designed to provide benefits to new immigrants. One of these laws is the Tax Code.

Immigration to Israel, as a newly formed State was always coupled with emigration from Israel. The return of these Expatriates and their absorption within the State are viewed as a national priority. This goal is evident by the Tax Laws.

Since Israel is a democracy with no discrimination in its laws, the tax laws apply to every new or returning resident regardless of such individual's religion, nationality or gender.

I. Who is an Israeli resident

Section 1 of the Tax Ordinance defines an Israeli resident as an individual whose centre of life is in Israel. In order to establish where the individual's centre of life is, the individual's family, economic and social ties should be measured and evaluated. Among other things these ties may be evidenced by the following:
- The location of the individual’s permanent home;
- The location of the individual’s actual home and that of his family;
- The location of the individual’s business or work;
- The location of the individual’s economic interests;
- The location of the individual’s activity in organisations, associations and institutions.

As if not complicated enough the court in several rulings established another test which is the "subjective test", meaning where the individual himself sees his centre of life. In a recent ruling the court stated that it is possible that an individual will have his centre of life in one place and his spouse and children in another. This is possible due to the subjective test.

Another test mentioned in Section 1 is the 183 days test. If an individual is present in Israel for a period of 183 days or more he is presumed to be an Israeli resident but the individual is entitled to rebut the presumption by proving that his centre of live is elsewhere.

The law distinguishes between a new resident and a returning resident. A new resident is an individual who was never a resident of Israel. A returning resident is an individual who was a resident of Israel and prior to his return, was resident in a foreign country for at least three consecutive years. An individual who was a resident of a foreign country for less than three years has no tax benefits.

II. Exemptions on passive income

A new resident's income derived from interest or dividend payments, royalty, rent or pension originating out of Israel and is not business income is exempt for a period of five years, from the time the individual becomes an Israeli resident. This exemption also applies to returning residents on income from assets bought while the individual was a resident of foreign country.

Possible tax steps to maximise benefits:

1 This article deals with tax aspects of new residents from the Israeli tax point of view. Tax aspects in a foreign country should be considered as well.
2 This may contradict Israel's tax treaties in some respect.
• It is more than likely that the movement of the sources of income from abroad into Israel is not advisable from a tax point of view, at least for the first five years.
• Since the exemptions apply only on income from assets the individual acquired before he became an Israeli resident, every investment in assets out of Israel must be made prior to the arrival in Israel.
• Passive income is fully exempt while active income is fully taxable. For example, dividend income is fully exempt while salary income is taxable. Where possible, an individual should receive passive income.
• While passive income is exempt in Israel it is not necessarily the case in the state in which the income is produced. Professional advice and review of tax treaties can minimise foreign taxes.

III. Exemptions on business income

A new resident is exempt from the payment of tax on business income for four years if the business is located out of Israel and if the new comer possesses it for a period of five years before arrival. This exemption does not apply to returning residents.

Possible tax steps to maximise benefits:
• A new resident is exempt for four years but only if the business was owned by such individual for five consecutive years prior to his arrival in Israel. If the business is owned by such individual for less than five years changes of the sources of the income from business income to passive income are advisable. One possibility is renting the business and receiving rent income rather than business income. Another possibility is selling the business and using the compensation to acquire assets that will produce passive income.
• The change of residency is, in most cases, in the hands of the individual. Where justified, waiting for the period of five years to pass should be considered.
• Proper documentation must be kept to prove the five year period.

IV. Exemptions on capital gains

A new resident is exempt from the payment of taxes on capital gains from sale of assets acquired before his arrival in Israel if he sold the assets within a period of ten years from the day of arrival. If he failed to sell an asset within ten years he will be liable for capital gain tax only on the portion of the gain which relates to the period beginning at the end of the ten year period. This exemption applies to returning residents on assets bought when the individual was a resident of a foreign country.

Possible tax steps to maximise benefits:
• The best time to buy assets is shortly before the change of residency and not thereafter. A sale of an asset bought after the change of residency is taxable.
• Converting options into stocks should be considered since the sale of stock after an individual's arrival in Israel is exempt for a period of ten years. On the other hand, if he arrived with options which are converted to stock after arrival, the sale of the stock will be taxable.
• If future activities outside of Israel are planned, it may be advisable to establish several companies before arriving to Israel and performing any future activities through these companies. Capital gains from the sale of the shares can be exempt while selling a new business will be taxable.
• Planning passive income with capital gains is recommended. For example, since dividend income is exempt for only five years while capital gains from the sale of shares is exempt for ten years, possible planning is to withdraw dividend for five years and then accumulate future income in the foreign company and sell it.
V. Exemption on interest income on foreign currency deposit

The income tax directive exempts interest income on foreign currency deposit in an Israeli bank if several conditions are met. The most important conditions are that the funds were owned by the new resident prior to his arrival, it was deposited within 90 days from the day it was brought to Israel, proper documentation was delivered and the deposit is for a period of at least three months. If all conditions are met there is an exemption for a period of twenty years from the day of arrival. For example, if a new resident delivers his money three years after his arrival into a deposit that fulfils all conditions, the interest from the deposit will be exempt for seventeen more years. A similar directive applies to returning residents on money accumulated while they were not Israeli residents but only for a period of five years.

VI. Tax reduction on pensions

Pension payments received by a new resident are taxable after the five year period during which the exemption is applicable. Taxation of a pension payment received from a former employer or from a pension fund for work in a foreign country can not exceed the tax that would have been paid in the foreign country if the new resident would have stayed there. This tax reduction is also given to a returning resident but only if he left Israel as a minor. Special documentation must be prepared in order to receive this reduction

Possible tax steps to maximise benefits:

- A new resident receiving pension payments can receive a tax reduction as explained above. Yet, due to tax benefits for pensions available for every resident of Israel, in certain cases it is advisable not to use this benefit but the regular benefits for pensions.

VII. Conclusion

New residents and returning residents have a few significant tax benefits. These benefits should be examined before the change of residency. After the arrival, no changes may be made in order to maximize the tax benefits. With the right planning a new resident can enjoy years of exemptions on income and can realize profits from assets he possesses in full exemption from capital gains tax. A wise use of the tax treaties can help the new resident or returning resident to minimize even foreign taxes.

SHAI DOVER

Shai Dover, CPA(Isr), MBA, TEP was a National Tax Inspector employed by the Income Tax Authority until 31st December 2004. Mr. Dover was involved in a variety of domestic and international tax aspects including New residents, Tax Treaties, CFC's, Withholding Taxes, Transfer Pricing and other various tax matters. Mr. Dover, of Shai Dover accounting firm, was the Secretary of the Public Committee for the Taxation of Trusts.

**This article is updated to November 9, 2005**