European Tax Newsalert

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ISRAEL

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Israeli Government approves proposed tax reform including an increase in the Corporate Tax Rate

On October 30, 2011, the Israeli Government approved a significant proposal to reform certain aspects of the Israeli tax rules (the "Proposal"). The Proposal was recommended by a special committee (the "Committee"), which was headed by Professor Manuel Trachtenberg, and appointed by the Government on August 8, 2011 to review Israel's social and economic welfare with the purpose of reducing the cost of living for middle and lower class taxpayers.

The Committee presented its Report to the public on September 26, 2011. The Report addressed a variety of social and economic reforms including various changes to some of Israel's tax provisions.

The legislative Proposal is currently pending further legislation procedures, e.g., its approval by the Israeli Parliament. If the Proposal is enacted, these changes are expected to be effective January 1, 2012. Additional considerations and discussions with regards to future Israeli tax matters are expected to continue through the end of 2014.

The key proposed amendments that may impact investment into Israel have been set out below

Highlights of the Proposed Israeli Tax Reform

Increase in the Corporate Tax Rate ("CTR") and postponement of the scheduled CTR reduction

Under current law, the 2011 24% CTR will be gradually reduced to 23% in 2012, 22% in 2013, 21% in 2014, 20% in 2015, and to 18% in 2016.

The Proposal would not only abolish the scheduled CTR reduction but would also increase the CTR to 25% in 2012. The Committee also recommended to consider a further increase of the CTR to 26% in 2013. This will depend, amongst other things, on the future fiscal environment in Israel.

Note that the Committee did not recommend any changes in the reduced beneficial tax rates available to companies that are enjoying Approved Enterprise benefits under the Law for the Encouragement of Capital Investments.

Increase in the Personal Income Tax ("PIT") Rates and postponement of the scheduled PIT reduction

Under current law, the maximum marginal 45% PIT rate (for a monthly income beyond US$ 10,900) and PIT rate on an individual's employment income are scheduled to gradually decrease to 39% by 2016.

The Proposal would abolish the scheduled reduction in PIT rates and the maximum marginal PIT rate would increase to 48% in 2012. Furthermore, for high-income individuals whose total income from all sources (e.g., work income, capital investment income) exceeds NIS 1 million annually (approximately US$270,000), an additional marginal 2% tax rate (i.e., set at 50%) would apply to their income.

Increase of tax rates on Interest, Dividends and Capital Gains

Under current law, the general tax rate applicable on interest, dividends and capital gains is 20%. A 25% tax rate applies for dividends and capital gains generated by substantive shareholders (i.e., broadly, shareholders owning 10% or more of the shares in the company).

Under the Proposal, the general tax rate will increase from 20% to 25% and the tax rate on dividends and capital gains for substantive shareholders will increase from 25% to 30%.

These rates can be reduced or the income exempted for foreign tax residents in accordance with the provisions of foreign domestic tax law or an applicable tax treaty.

National Insurance

Under current law, the National Insurance rates for employer and employee are applied on an individual's monthly compensation up to prescribed monthly threshold amounts which have been set as an interim measure at NIS 73,422 (approximately US$19,850).

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The Proposal would decrease the monthly threshold amount to five times the average monthly compensation amount (i.e., monthly threshold of approximately NIS 41,000 [approximately US$11,000]).

Additional tax recommendations considered by the Committee

The Committee also considered additional important tax reform actions and eventually decided not to change them. Some of these considerations included:

- Under current law, Israel has no estate or inheritance tax. Although such taxes may generate tax revenues for the social changes recommended, the Committee recommends that it will continue to not impose any estate or inheritance taxes.

  The VAT rate in Israel (currently 16%) will not be reduced nor will certain consumer products be eligible for an exempt rate of VAT notwithstanding public encouragement to reduce the VAT rate and exempt VAT for certain products.

Summary

If the Proposal is approved and enacted, these changes may significantly impact U.S. and other multinationals with investments or operations in Israel.

Therefore, investors should analyze the potential impact on their investments and plan accordingly.

For more information, please do not hesitate to contact:

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