New Israeli tax law could affect US multinationals

August 19, 2013

In brief

The Israeli Parliament (the Knesset) on July 29, 2013, passed significant amendments to the Israeli tax laws. These amendments, which are intended to increase tax revenues, were officially published on August 5, 2013, and generally will be effective from January 1, 2014. The most significant aspects of the new legislation are described below. The new legislation increased the tax rates that apply to regular corporations as well as to corporations that are eligible for a beneficial tax regime.

US MNCs with Israeli investments may face higher effective tax rates on their investments in Israel – both investments in regular Israeli corporations as well as investments in corporations that are eligible for a beneficial tax regime.

In detail

Corporate tax rate increases

Effective January 1, 2014, the regular corporate tax rate will increase to 26.5% from the current 25%.

Approved Enterprise tax rate increases

A company that has been granted approved enterprise (AE) status may take advantage of certain tax benefits as well as cash grants under the Encouragement of Capital Investments Law (the AE law).

Following amendments to the AE law that took effect January 1, 2011 (the 2011 amended law), a company with AE status may elect to be taxed on its AE income at flat rates that vary depending upon whether the AE is located in 'geographic area A' (generally, rural or less developed areas) or in the rest of the country.

The 2011 amended law set out flat rates that were scheduled to decrease gradually through 2015, as follows:

Year	Area A	Rest of country
2011-2012	10%	15%
2013-2014	7%	12.5%
2015 and thereafter	6%	12%

Under the new legislation, the scheduled reductions in tax rates for 2014 and 2015 have been cancelled. Instead, the AE rates will increase, effective January 1, 2014, as follows:

Year	Area A	Rest of country
2014 and thereafter	9%	16%

The AE rate increase under the new legislation will not apply to AEs still governed by the AE law prior to its amendment in 2011.

Companies subject to the 'old' (pre-amendment) AE Law may elect to shift to the 2011 amended law AE regime. This election, once made, is irrevocable. (See January 2011 European Tax Newsalert, *Israel - New Legislative Amendments to the Encouragement of Capital Investments Law*)

Observation: The increased rates may discourage AEs subject to the 'old' pre-amendment regime from electing to transition to the 2011 amended law AE regime.

Increased withholding on distributions of AE profits

Israeli domestic tax law currently imposes 15% withholding on distributions of AE profits earned during the relevant AE benefit period. Effective January 1, 2014, this withholding tax rate generally will increase to 20%.

These rates may be reduced by the provisions of an applicable tax treaty. Under the Israel-US tax treaty, the withholding tax on dividends distributed to a US corporate shareholder from AE-generated profits cannot exceed 15%.

Other tax-raising measures

Other key tax amendments in the new legislation include the following:

Distributions sourced from revalued assets (unrealized gains)

The new legislation introduces rules covering the situation in which a company distributes dividends sourced from unrealized profits arising from a revaluation of its assets for accounting purposes. The asset that generated the unrealized valuation gain now may be deemed to be sold on the date of the distribution, giving rise to tax on the imputed gain.

Value added tax (VAT)

The Israeli VAT rate increased from 17% to 18% effective June 2, 2013.

The takeaway

US MNCs with Israeli investments should carefully consider the changes in the corporate tax rates applicable to their Israeli investments to determine the impact on their effective tax rate as well as upon repatriation of profits from Israel.

Let's talk

For a deeper discussion, please contact:

International Tax Services, Israel

Shlomi Zehavi
+972 (0) 3 795 4 478
shlomi.zehavi@il.pwc.com

Yair Zorea
+972 (0) 3 795 4 465
yair.zorea@il.pwc.com

Zeev Katz
+972 (0) 3 795 4 486
zeev.katz@il.pwc.com