



# Doing business in **ISRAEL**



# Welcome

February 2015

We are honored to present you with EY's new guide to doing business in Israel.

Over the years, Israel has become a hotbed for many startups and mature companies and has provided numerous opportunities for growth and success.

The guide provides general information and insights into the local business arena including: the Israeli economy, starting a business, corporate taxation and other accounting aspects to be considered.

At EY, we are committed to helping our clients build a better working world and will be happy to assist you in turning your vision into reality.

Sincerely,



Ronen Barel  
Chairman  
EY Israel

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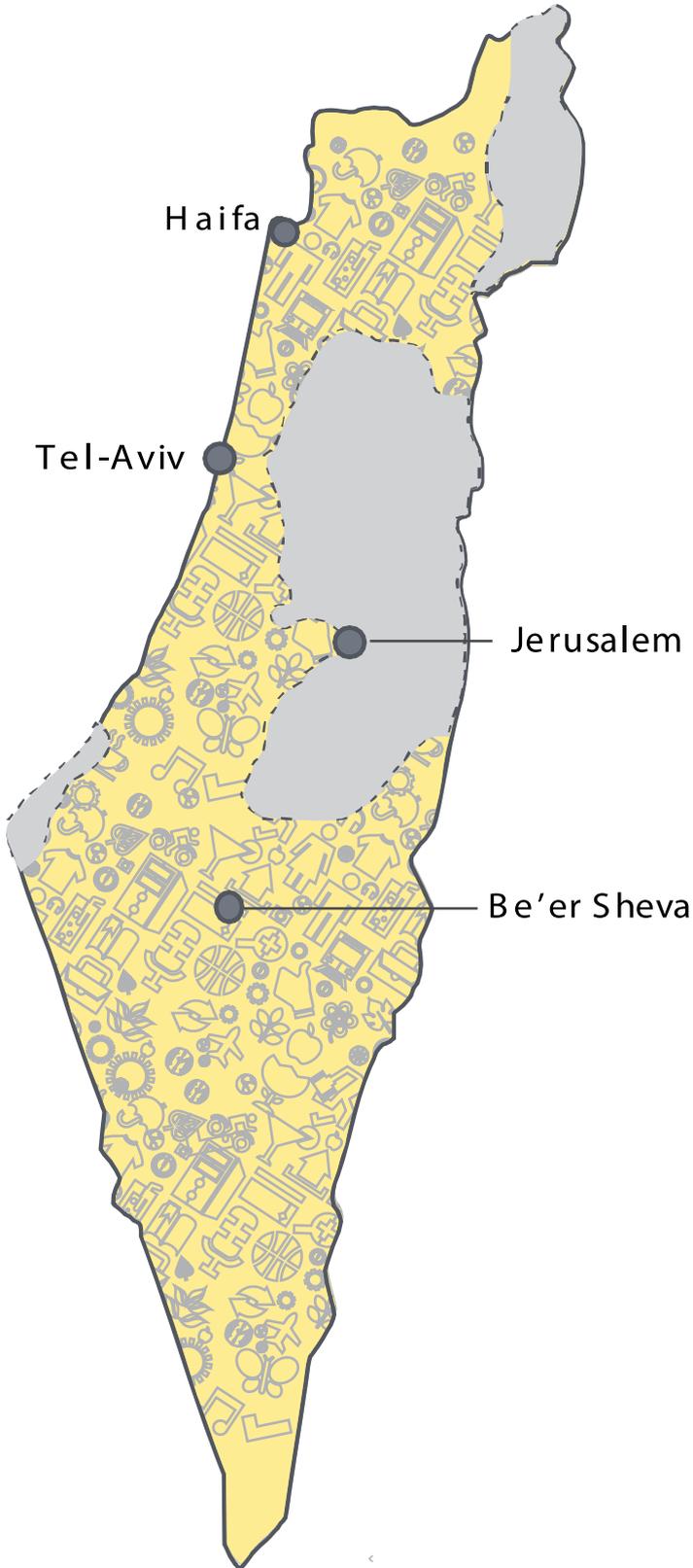
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# Israel at a glance



## Location

Israel is located in the Middle East. It lies at the junction of three continents: Europe, Asia and Africa.



## Geography

The country is about 290 miles (470 km.) in length and 85 miles (135 km.) in width at its widest point.



## Language

The official languages are Hebrew and Arabic.



## Climate

Israel's climate is characterized by much sunshine, with a rainy season from November to April.



## Population

Israel's population is approximately 7.8 million - Jews comprise some 75.4% of the country's population, while the country's non-Jewish citizens number about 24.6%.



## Living

About 90% of Israel's inhabitants live in some 200 urban centers. About 5% are members of unique rural cooperative settlements - the kibbutz and the moshav.



## Main cities

Jerusalem, Israel's capital, Tel Aviv-Yafo, Haifa and Be'er Sheva.



## System of government

Israel is a parliamentary democracy. The head of the state is the president. The position is largely an apolitical ceremonial figurehead role. The Knesset, Israel's legislative authority, is a 120-member unicameral parliament. Its members are elected every four years. The government (cabinet of ministers) is charged with administering internal and foreign affairs. It is headed by a prime minister and is collectively responsible to the Knesset.



## Education and science

School attendance is mandatory from age five, and free through age 18. Israel's institutions of higher education include universities and colleges.



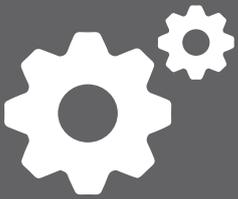
## Health

The National Health Insurance Law, in effect from January 1995, provides for a standardized basket of medical services, including hospitalization, for all residents of Israel.



## National Insurance Institute

The National Insurance Institute provides all permanent residents (including non-citizens) with a broad range of benefits, including unemployment insurance, old-age pensions, survivors' benefits, maternity grants, allowances and more.



# Israel's economy

## Business and investment environment



Israel's large concentration of talented and innovative people makes it an ideal place for investment. Characterized by groundbreaking entrepreneurship, Israel yields pioneering technologies, profitable business opportunities and high investment returns. This is why so many major multinationals have chosen to invest in Israel including: Microsoft, Berkshire-Hathaway, Motorola, Intel, HP, Siemens, GE, IBM, Philips, Lucent, AOL, Cisco, Applied Materials, Oracle, J&J and more. Listed below are highlights of the record, resources and support that make Israel a smart investment today and tomorrow.

### Government support

The State of Israel encourages local and foreign investment by offering grants, reduced tax rates and other tax related benefits through the Law for the Encouragement of Capital Investments. In addition, The Law for the Encouragement of Industrial R&D offers conditional grants of up to 50 percent of approved research and development programs. Israel offers one of the world's most advanced infrastructures and services required to conduct business efficiently and effectively. Israel boasts a sophisticated communications system; reliable energy infrastructure; well-developed transportation system with modern international gateways; protection of trademarks, patents, and other intellectual property; highly developed and transparent financial systems and a legal system based on common and corporate law.

### OECD

After years of actively participating in the OECD's various committees, Israel officially joined in 2010. This is due to the country's substantial achievements in the economy, high-tech, water and desert solutions, education and environment, as well as its ability to cope with social gaps. The organization, which was founded in 1961, is a club of developed, democratic and liberal countries, whose representatives meet and work to coordinate their policies in the economic, social, environment and financial fields.

### Central bank

The Bank of Israel's responsibilities include:

- ▶ Regulating and directing monetary policies
- ▶ Economic advice to the government
- ▶ Foreign currency market and managing the foreign exchange reserves
- ▶ Monitoring and analyzing foreign exchange activity

- ▶ Banking supervision
- ▶ Promoting financial stability
- ▶ Currency issues
- ▶ Banker of the government of the banks
- ▶ Representing Israel in international institutions

### Stock exchange

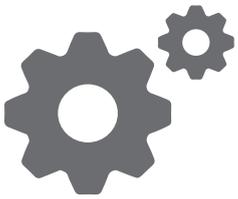
The Tel Aviv Stock Exchange (TASE) fulfills a major role in the Israeli economy and is a key player in the nation's economic growth. It currently lists some 600 companies, about 40 of which are also listed on foreign stock exchanges worldwide. TASE also lists some approximately 600 exchange-traded funds (ETFs), 31 government bonds, about 600 corporate bonds, and over 1300 mutual funds. In addition, approximately 75 Israeli companies are listed on the Nasdaq.

### Banking system

The banking system plays a central role in every advanced economy: it is there that the public deposits the bulk of its financial savings, which are used by the banks to provide credit to firms and households. Most payments are made via the current accounts (demand deposits) which are handled by the banks; foreign currency transactions are also usually executed via the banks. Israel's banking system operates in other spheres, too, administering provident and mutual funds and acting as their trustees, administering customers' securities, functioning as custodian, underwriter, distributor, and dealer in securities on the stock exchange, serving as a financial advisor, etc.

### The supervisor of banks

The supervisor of banks is appointed by the Governor of the Bank of Israel. Two committees operate alongside the Supervisor: The Licenses Committee and The Advisory Committee.



# Israel's economy

## Financial criteria

Criteria	2011	2012	2013
<b>GDP</b>			
GDP in current prices (B NIS) in Billion dollars*	924 258.2	993 257.6	1053 291.4
GDP growth rate**	4.7 %	3.1%	3.3%
<b>Exports &amp; imports</b>			
Exports in current prices (B NIS) in Billion dollars* % of GDP	288.8 80.7 31.3%	327 84.8 32.9%	309.4 85.7 29.4%
Imports in current prices (B NIS) in Billion dollars* % of GDP	296.6 82.9 32.1%	328.5 85.2 33.1%	300 83.1 28.5%
<b>Inflation</b>			
Inflation rate	2.2%	1.6%	1.8%
<b>Average exchange rate</b>			
Average exchange rate USD/NIS Average exchange rate Euro/NIS	3.58 4.98	3.86 4.96	3.61 4.80
<b>Total investments by foreigners</b>			
Total investments by foreigners Million \$	5,379	1,120	13,855

\* Using an average annual exchange rate USD/NIS

\*\* In current prices

\*\*\* Indicators taken of Bank of Israel annual report 2013

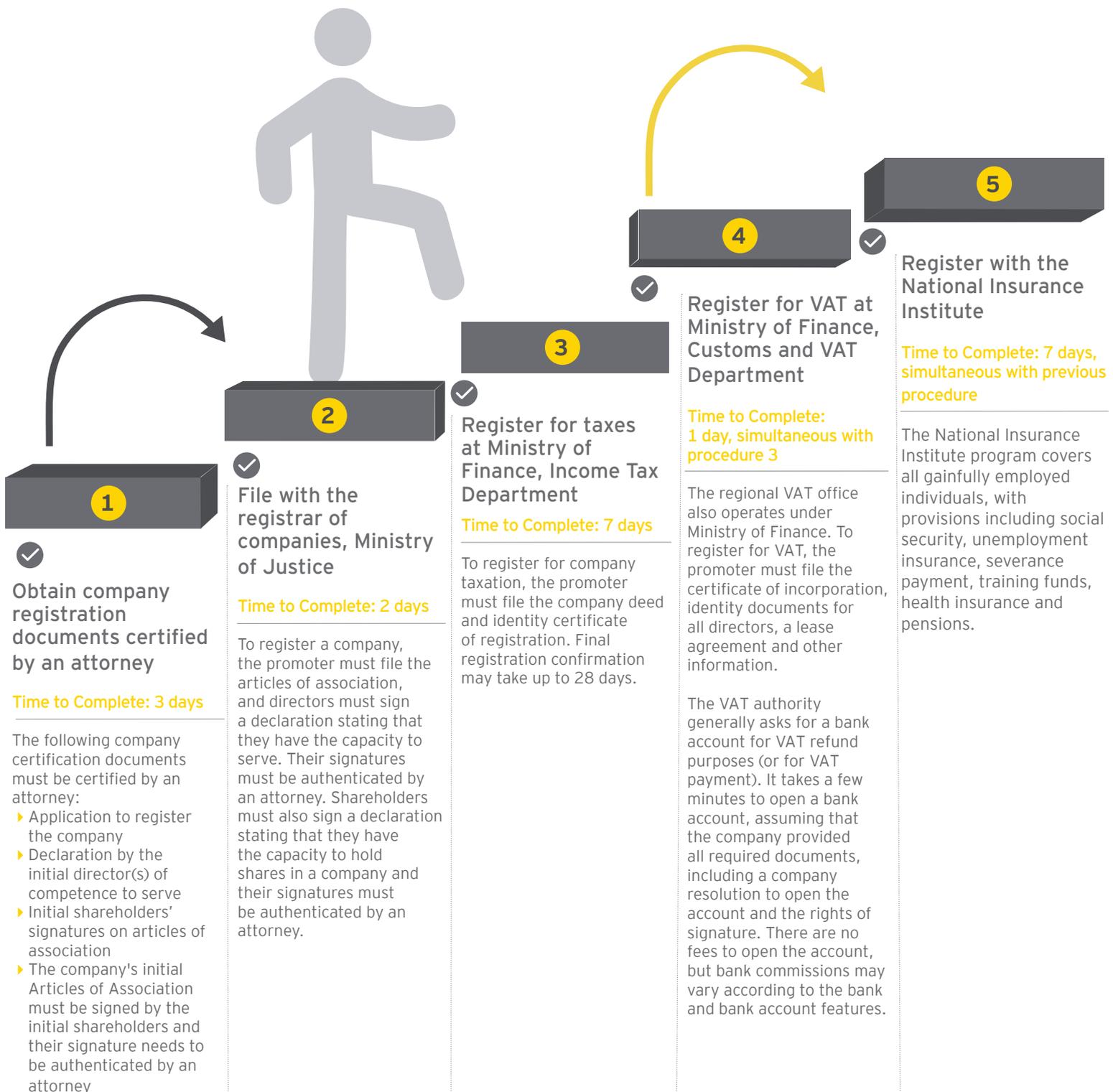


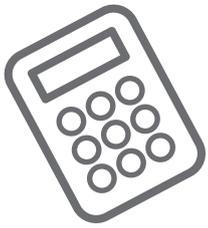


# Starting a business

## Steps to starting a business in Israel

Following is the list of procedures for starting a business in Israel:





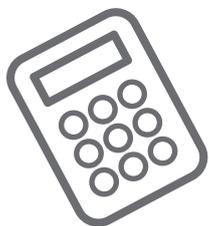
# Corporate taxation

## At a glance

Corporate income tax rate (%)	26.5(a)
Capital gains tax rate (%)	26.5 (a)(b)
Branch tax rate (%)	26.5 (a)
Withholding tax (%)	
Dividends	0/15/20/25/30 (c)(d)
Interest	0/15/26.5/25 (a)(c)(e)(f)
Royalties from patents, Know-how, etc.	26.5 (a)(c)(e)
Branch remittance tax	0
Net operating losses (years)	
Carryback	0
Carry forward	Unlimited



- (a) This is the regular company tax rate for profits and real capital gains, effective from 1 January 2014 (the rate was 25% for 2013). Reduced rates of company tax are available in accordance with the Capital Investment Encouragement Law (for details, see Section B).
- (b) See Section B for details.
- (c) The withholding tax may be reduced by applicable tax treaties.
- (d) The 0% rate generally applies to distributions to Israeli parent companies. In addition, effective from 1 January 2014, reduced withholding tax rates of 15% and 20% may apply under the Capital Investment Encouragement Law (15% previously).
- (e) In principle, the withholding taxes on interest and royalties are not final taxes.
- (f) Interest paid to non-residents on Israeli corporate bonds registered for trading on the Tel-Aviv Stock Exchange is exempt. In general, interest paid to non-residents on Israeli governmental bonds is exempt. However, interest on short-term bonds (issued for 13 months or less) is taxable. Interest paid to individual may be taxed at 15% in certain circumstances.



# Corporate taxation

## Taxes on corporate income and gains

### Corporate income tax

Resident companies are subject to Israeli tax on their worldwide income. Non-resident companies are subject to Israeli tax on income accrued or derived in Israel, unless otherwise provided for in an applicable tax treaty.

A company is considered resident in Israel for Israeli tax purposes if either of the following applies:

- ▶ It is incorporated in Israel
- ▶ Its business is controlled and managed in Israel

### Rates of corporate tax

Effective from 1 January 2014, the regular rate of company tax is 26.5% (25% for 2013). The following are the combined Israel taxes on profits, taking into account the 30% withholding tax on dividends paid to shareholders holding 10% or more of the company (material shareholders) and the 25% withholding tax imposed on shareholders holding less than 10% of the company, or on 10% or more shareholders of an Israeli company listed on a stock exchange:

- ▶ Material shareholders: 48.55% for 2014 and future years. Holders that are individuals who have a taxable income that exceeds NIS811,560 for 2013 (linked to the Consumer Price Index each year) may be subject to an additional tax at a rate of 2% on their taxable income in excess of NIS811,560.
- ▶ Other shareholders: 44.875% for 2014 and future years. For individual holders, an additional tax of 2% may apply (see above).

The dividend withholding tax rates mentioned above may be reduced based on applicable tax treaties.

### Tax levy on oil and gas

Under the Windfall Profits Tax Law, effective from 10 April 2011, a levy is imposed on oil and gas profits from an oil or gas project in the relevant tax year. The levy is designed to capitalize on the economic dividend arising from each individual reservoir. The levy is imposed only after the investments in exploration, development and construction are fully returned plus a yield that reflects, among other items, the developer's risks and required financial expenses. The levy is progressive and has a relatively lower rate when first collected, and increases as the project's profit margins grow.

### Tax reductions and exemptions

The major tax reductions and exemptions offered by Israel are described in the section below.

### Capital gains and losses

**Residents** - Resident companies are taxable on worldwide capital gains. Capital gains are divided into real and inflationary components. The following are descriptions of the taxation of these components:

- ▶ Effective from 1 January 2014, the tax rate on real capital gains is the standard corporate tax rate of 26.5%.

- ▶ The inflationary component of capital gains is exempt from tax to the extent that it accrued on or after 1 January 1994, and is generally taxable at a rate of 10% to the extent that it accrued before that date. Gains derived from sales of Israeli real estate or from sales of interests in real estate associations (entities whose primary assets relate to Israeli real estate) are subject to Land Appreciation Tax at rates similar to those applicable to other capital gains.

Capital losses may be used to offset capital gains derived in the same or future tax years without time limit. In each year, capital losses are first offset against real gains and then offset against taxable inflationary amounts in accordance with the following ratio: NIS3.5 of inflationary amounts per NIS1 of capital losses. Capital losses from assets located abroad must be offset against capital gains on other assets abroad, then against capital gains from assets in Israel.

Capital losses incurred on securities can also be offset against dividend and interest income in the same year, subject to certain conditions.

**Non-residents** - Unless a tax treaty provides otherwise, in principle, non-resident companies and individuals are subject to Israeli tax on their capital gains relating to any of the following:

- ▶ An asset located in Israel
- ▶ An asset located abroad that is primarily a direct or indirect right to an asset, inventory or real estate in Israel or to a real estate association (an entity whose primary assets relate to Israeli real estate). Tax is imposed on the portion of the consideration that relates to such property in Israel.
- ▶ Shares or rights to shares (for example, warrants and options) in an Israeli resident entity
- ▶ A right to a non-resident entity that primarily represents a direct or indirect right to property in Israel. Tax is imposed on the portion of the consideration that relates to such property in Israel.

Foreign residents not engaged in business in Israel may qualify for exemption from capital gains tax on disposals of the following investments:

- ▶ Securities traded on the Tel-Aviv stock exchange (with certain exceptions).
- ▶ Securities of Israeli companies traded on a recognized foreign stock exchange.

The above exemption does not apply to the following:

- ▶ Gains attributable to a permanent establishment (generally a fixed place of business) of the investor in Israel
- ▶ Shares of Real Estate Investment Trust (REIT) companies
- ▶ Capital gains derived from the sale of Israeli governmental short-term bonds (issued for 13 months or less)

Foreign residents may also qualify for an exemption from capital gains tax on disposals of all types of Israeli securities not listed to trade that were purchased on or after 1 January 2009 if certain conditions are met including securities that were not acquired by a related party nor as part of a tax free reorganization in Israel.



# Corporate taxation

The above exemption does not apply to the following:

- ▶ Gains attributable to a permanent establishment (generally a fixed place of business) of the investor in Israel
- ▶ Shares of a company whose assets are principally Israeli real estate
- ▶ Shares of a company that has the value of its assets derived principally from the usufruct of immovable property and right to payments as consideration for the working of, the right to work, mineral deposits, sources and other natural resources (for example, companies that hold licenses to exploit gas and minerals in Israel's territory, which includes Israel's economic water).

In other cases, unless a tax treaty provides otherwise, foreign resident companies pay capital gains tax in accordance with the rules and rates applicable to Israeli resident companies, as described above. However, non-residents investing with foreign currency may elect to apply the relevant exchange rate rather than the inflation rate to compute the inflationary amount.

## Administration

The Israeli tax year is normally the calendar year. However, in some cases (e.g., subsidiaries of foreign publicly traded companies) may sometimes be allowed to use a different fiscal year.

Companies are generally required to file audited annual tax returns and financial statements within five months after the end of their fiscal year, but extensions may be obtained.

Companies must normally file monthly or bimonthly reports and make payments with respect to the following taxes:

- ▶ Company tax advances, which are typically computed as a percentage of a company's sales revenues
- ▶ Supplementary company tax advances with respect to certain nondeductible expenses
- ▶ Tax and social security contributions withheld from salaries and remittances to certain suppliers
- ▶ VAT

Non-residents are required to appoint an Israeli tax representative and VAT representative if any part of their activities is conducted in Israel. The VAT representative is deemed to be the tax representative if no other tax representative is appointed. The tax representative is empowered to pay tax out of the foreign resident's assets.

## Dividends

A 30% withholding tax is generally imposed on dividends paid to individual shareholders holding 10% or more of the shares in an Israeli company (material shareholders). A 25% withholding tax is imposed on dividends paid to individual shareholders holding less than 10% of the shares in an Israeli company. However, resident companies are exempt from company tax on dividends paid out of regular income that was accrued or derived from sources within Israel. Companies are generally subject to tax at a rate of 25% on foreign dividend income that is paid from a foreign source or from income accrued or derived abroad (foreign-source income that is passed up a chain of companies).

A reduced withholding tax of 15% or 20% is imposed on dividends paid out of the income of a company entitled to the benefits of the Capital Investment Encouragement Law. The rate may be further reduced under an applicable tax treaty. However, if such dividend is paid to an Israeli company, it is generally exempt from withholding tax (with certain exceptions).

## Interest

Israeli resident companies are taxable on worldwide interest, original discount and linkage differentials income. The tax rate for these types of income is the standard corporate tax rate of 26.5%. Individuals may be subject to tax at 15% on interest income from certain instruments that are not linked to the Israeli Consumer Price Index. Interest, original discount and linkage differentials income are generally treated as derived from Israeli sources if the payer is located in Israel. In principle, the same taxation rules apply to non-Israeli resident companies on Israeli-source interest, original discount and linkage differentials income, unless a tax treaty provides otherwise.

Nevertheless, an exemption from Israeli tax is available to foreign investors that receive interest income on bonds issued by Israeli companies traded on the Israeli stock exchange. In addition, interest paid to non-residents on Israeli governmental bonds that are issued for more than 13 months is exempt.

## Israeli holding companies and participation exemption

To qualify for the participation exemption, an Israeli holding company must satisfy various conditions, including the following:

- ▶ It must be incorporated in Israel
- ▶ Its business is controlled and managed in Israel only
- ▶ It may not be a public company or a financial institution
- ▶ It must not have been formed in a tax-deferred organization
- ▶ For 300 days or more in the year, beginning in the year after incorporation, the holding company must have an investment of at least NIS50 million in the equity of, or as loans to, the investee companies, and at least 75% of the holding company's assets must consist of such equity investments and loans.

In addition, the foreign investee company must satisfy the following conditions:

- ▶ It must be resident in a country that entered into a tax treaty with Israel, or it must be resident in a foreign country that had a tax rate for business activity of at least 15% on the date of the holding company's investment (however, it is not required that the investee company pay the 15% tax [for example, it obtains a tax holiday]).
- ▶ At least 75% of its income in the relevant tax year is accrued or derived from a business or one-time venture abroad.
- ▶ The Israeli holding company must hold an "entitling shareholding" in the investee company for at least 12 consecutive months. An "entitling shareholding" is a shareholding that confers at least 10% of the investee's profits. The entitling shareholding must span a period of at least 12 months that includes the date on which the income is received.



# Corporate taxation

An Israeli holding company is exempt from tax on the following types of income:

- ▶ Capital gains derived from the sale of an entitling shareholding in an investee company
- ▶ Dividends distributed during the 12-month minimum shareholding period with respect to an entitling shareholding in an investee company
- ▶ Interest, dividends and capital gains derived from securities traded on the Tel-Aviv Stock Exchange
- ▶ Interest and indexation amounts received from Israeli financial institutions

In addition, dividends paid by Israeli holding companies to foreign resident shareholders are subject to a reduced rate of dividend withholding tax of 5%

## Foreign tax relief

A credit for foreign taxes is available for federal and state taxes but not municipal taxes. Any excess foreign tax credit may be offset against Israeli tax on income from the same type in the following five tax years.

With respect to foreign dividend income, an Israeli company may opt to tax such in one of the following manners:

1. 25% on dividend income with credit on foreign tax withheld at source, or
2. Underlying tax credit - 26.5% on gross up dividend income with credit on foreign tax imposed on earning from which the dividend was distributed and withholding tax. Note that the underlying tax credit is available up to two tiers structure only provided that certain conditions are met.

Foreign residents that receive little or no relief for Israeli taxes in their home countries may be granted a reduced Israeli tax rate by the Minister of Finance.

## Determination of trading income

### General

Taxable income is based on financial statements that are prepared in accordance with generally accepted accounting principles and are derived from acceptable accounting records. In principle, expenses are deductible if they are wholly and exclusively incurred in the production of taxable income. Various items may require adjustment for tax purposes, including depreciation, R&D expenses as well as vehicle and travel expenses.

## Inventories

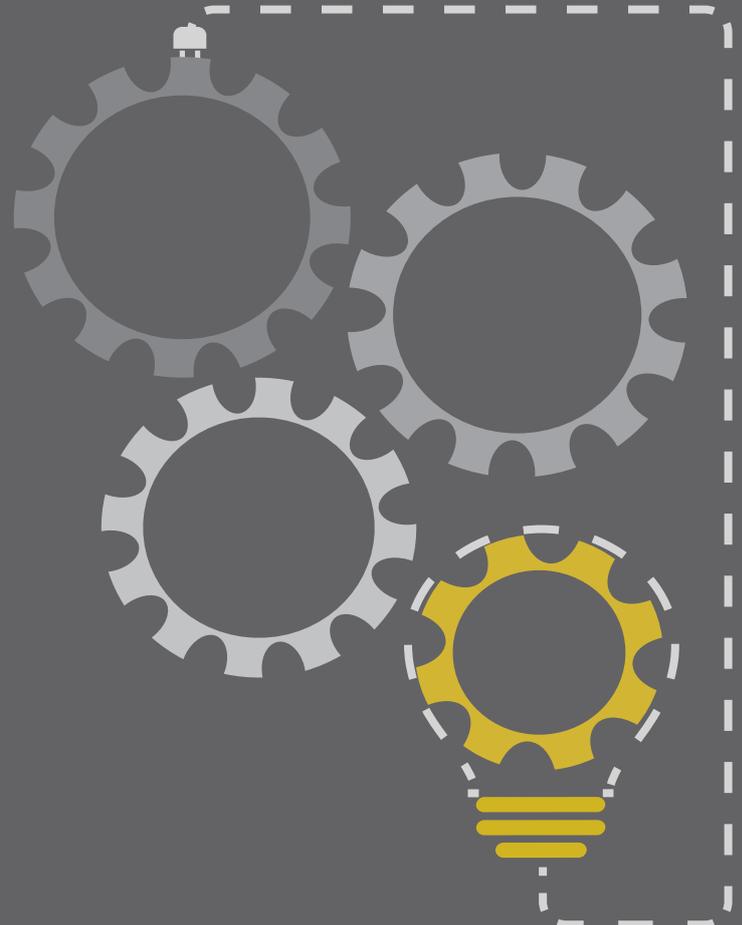
In general, inventory may be valued at the lower of cost or market value. Cost may be determined using one of the following methods:

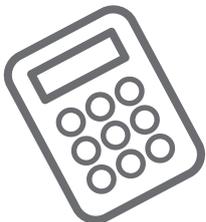
- ▶ Actual
- ▶ Average
- ▶ First-in, first-out (FIFO)

The last-in, first-out (LIFO) method is not allowed.

## Provisions

Bad debts are deductible in the year they become irrecoverable. Special rules apply to employee-related provisions, such as severance pay, vacation pay, recreation pay and sick pay.





# Corporate taxation

## Depreciation

Depreciation at prescribed rates, based on the type of asset and the number of shifts the asset is used, may be claimed with respect to fixed assets used in the production of taxable income. Accelerated depreciation may be claimed in certain instances. For example, under the Inflationary Adjustments Regulations (Accelerated Depreciation), for assets first used in Israel between 1 June 1989 and 31 December 2013, industrial enterprises may depreciate equipment using the straight-line method at annual rates ranging from 20% to 40%. Alternatively, they may depreciate equipment using the declining-balance method at rates ranging from 30% to 50%. The following are some of the standard straight-line rates that apply primarily to non-industrial companies.

Asset	Rate
Mechanical equipment	7 to 10
Electronic equipment	15
Personal computers and peripheral equipment	33
Buildings (depending on quality)	1.5 to 4
Goodwill*	10
Solar energy-producing plant	25

\* Subject to the fulfillment of certain conditions

## Groups of companies

Subject to certain conditions, consolidated returns are permissible for an Israeli holding company and its Israeli industrial subsidiaries if the subsidiaries are all engaged in the same line of production. For this purpose, a holding company is a company that has invested at least 80% of its fixed assets in the industrial subsidiaries and controls at least 50% (or two-thirds in certain cases) of various rights in those subsidiaries. For a diversified operation, a holding company may file a consolidated return with the subsidiaries that share the common line of production in which the largest amount has been invested.

Group returns may also be filed by an Israeli industrial company and Israeli industrial subsidiary companies if the subsidiaries are at least two-thirds controlled (in terms of voting power and appointment of directors) by the industrial company and if the industrial company and the subsidiaries are in the same line of production.

Detailed rules concerning the deferral of capital gains tax apply to certain types of reorganizations, including corporate mergers, divisions and shares-for-assets exchanges. In many cases, an advance ruling is necessary.

## Relief for losses

In general, business losses may be offset against income from any source in the same year. Unrelieved business losses may be carried forward for an unlimited number of years to offset business income, capital gains derived from business activities or business-related gains subject to the Land Appreciation Tax (see Section B). According to case law, the offset of losses may be disallowed after a change of ownership and activity of a company, except in certain bona fide circumstances.

Special rules govern the offset of foreign losses incurred by Israeli residents. Passive foreign losses may be offset against current or future foreign passive income (for example, income from dividends, interest, rent or royalties). Passive foreign rental losses arising from depreciation may also be offset against capital gains from the sale of the relevant foreign real property.

Active foreign losses (relating to a business or profession) may be offset against the following:

- ▶ Active foreign income and business-related capital gains in the current year
- ▶ Passive foreign income in the current year
- ▶ Active Israeli income in the current year if the taxpayer so elects and if the foreign business is controlled and managed in Israel. However, in the preceding two years and in the following five years, foreign-source income is taxable up to the amount of the foreign loss.
- ▶ Active foreign income and business-related capital gains in future years

## Other significant taxes

The following table summarizes other significant taxes.

Nature of tax	Rate (%)
Value-added tax (VAT), standard rate	18
Wage and profit tax, imposed on financial institutions instead of VAT; this tax is imposed in addition to company tax	

## Miscellaneous matters

### Foreign-exchange controls

The Israeli currency is the new Israel shekel (NIS). No exchange-control restrictions exist.

### Debt-to-equity rules

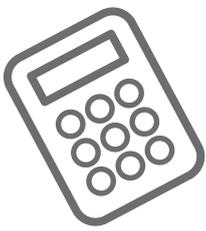
No thin-capitalization rules are imposed in Israel. However, approved enterprises and approved properties (see Section B) must be at least 30% equity-financed if they received their approval before 1 April 2005.

### Transfer pricing

Transactions between related parties should be at arm's length. Detailed transfer-pricing regulations apply. An Israeli taxpayer must report on each international transaction undertaken with a related party and indicate the arm's-length amount for such transaction. Advance rulings may be requested regarding to transfer pricing.

### Measures to counteract tax planning involving foreign companies

Certain measures are designed to counteract tax planning involving foreign companies.



# Corporate taxation

**Foreign professional companies** - Israeli residents are taxed on deemed dividends received from foreign professional companies (FPCs) at the standard corporate tax rate; a foreign corporate tax credit is available. In addition, on the actual distribution of dividends by FPCs, Israeli residents are subject to dividend tax. A company is considered to be an FPC if a company meets all of the following conditions:

- ▶ It has five or fewer ultimate individual shareholders
- ▶ It is owned 75% or more by Israeli residents
- ▶ Its controlling shareholders (holding 10% or more) or their relatives conduct a special profession for the company
- ▶ Most of its income or profits are derived from a special profession

The special professions include engineering, management, technical advice, financial advice, agency, law, medicine and many others.

**Controlled foreign corporations** - Israeli residents are taxed on deemed dividends received from a controlled foreign corporation (CFC) if they hold 10% or more of the CFC. An amendment to the CFC regime is effective from 1 January 2014. A foreign company (or any other body of persons) is considered to be a CFC if all of the following conditions exist:

- ▶ The foreign company primarily derives passive income or profits that are taxed at a rate of 15% or less abroad (20% previously).
- ▶ The foreign company's shares are not publicly traded, or less than 30% of its shares or other rights have been issued to the public or listed for trade.
- ▶ One of the following requirements is satisfied:
  - ▶ Israeli residents own either directly or indirectly more than 50% of the foreign company.
  - ▶ An Israeli resident owns over 40% of the foreign company, and together with a relative, owns more than 50% of the company.
  - ▶ An Israeli resident has veto rights with respect to material management decisions, including decisions regarding the distribution of dividends or liquidation.

The shareholdings of the CFC are calculated as the higher of the following:

- ▶ The shareholdings at the tax year-end
- ▶ The shareholdings any day in the tax year plus any day in the following tax year

The deemed dividend is the taxpayer's share of passive undistributed income on the last day of the tax year. Under the 2014 amendment, the possibility of claiming a deemed foreign tax credit is abolished.

**Reportable transactions** - Certain types of transactions with foreign companies must be reported to the tax authorities.

## **Withholding taxes on overseas remittances**

Any payer of income (including Israeli banks) must withhold tax, generally at a rate of 25%, from most overseas remittances unless the remittances relate to imported goods. An exemption or a reduced withholding rate may be obtained from the Israeli

tax authorities in certain circumstances, such as when a treaty applies or when the payments are for services that are rendered entirely abroad. A 30% withholding tax rate applies to dividends paid to recipients holding 10% or more of the payer entity.

## **Free-trade agreements**

Israel has entered into free-trade agreements with Bulgaria, Canada, the European Free Trade Association, the European Union, Mexico, Romania, Turkey and the United States.

## **Investment incentives**

### **General**

On January 1, 2011, a new amendment to the Law for the Encouragement of Capital Investment came into effect. The Law's objectives are to focus on achieving enhanced growth targets in the business sector, improving the Israeli industry's competitiveness in international markets and creating employment and development opportunities in outlying areas. Precedence will be granted to innovation and development areas. The country is divided into national priority areas, which are entitled to reduced tax rates and benefits based on the location of the enterprise.

### **Tax benefits**

A reduced uniform corporate tax rate for exporting industrial enterprises (over 25%) which applies to the industrial enterprise's entire income.

The reduced tax rate for development area A is 9% and for the rest of the country is 16%.

The reduced tax rate is not contingent on making a qualifying investment in productive assets.

A "preferred income" includes income that has been produced or generated by the Israeli production activity of a preferred enterprise.

**Tax on dividend** - A reduced dividend tax of 20% or less, subject to tax treaty will be imposed without distinction between foreign and local investors. Upon the distribution of a dividend to an Israeli company, no withholding tax will be remitted.

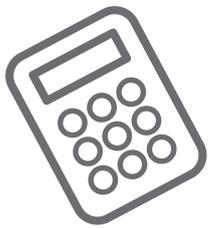
A unique tax benefit track will be granted to certain large industrial enterprises entitling them to a reduced tax rate of 5% in development area A and 8% in the rest of the country.

### **Grants**

An exporting industrial enterprise (over 25%) located in development area A may receive fixed asset grants of 20% - 32%.

### **Employment grants programs**

A variety of government support programs which encourage local enterprises to increase their number of new employees through participation in the new employees' monthly cost of wage. The average support is 20%- 33.75% of the monthly cost of wage, for a period of 30-48 months (according to relevant program).



# Corporate taxation

## Individual taxation

### Income tax

Who is liable? Israeli residents (individuals) are subject to tax on their worldwide income (including dividend, interest and capital gain). Non-resident (individuals) are subject to tax on income from an Israeli resident is defined as an individual whose center of living is in Israel, taking into account the person's family, economic and social links, including the following considerations:

- ▶ Permanent home
- ▶ Place of residence of the individual and his or her family
- ▶ Habitual place of business or permanent place of employment
- ▶ Place where assets and investments are located
- ▶ Place of membership in organizations, associations and institutions

In addition, under the law, a rebuttable presumption of Israeli residency will apply in either of the following circumstances:

- ▶ The individual is present in Israel at least 183 days in a tax year ending 31 December
- ▶ The individual is present in Israel at least 30 days in the current tax year and a cumulative total of 425 days in the current and two preceding tax years

Effective from 1 January 2007, if an individual is not considered an Israeli resident for two consecutive years (Years 3 and 4), the individual is also not considered an Israeli resident retroactively for the preceding two years (Years 1 and 2), provided that the individual spent less than 183 days in Israel during those preceding two years. For example, if an individual is not considered an Israeli resident in 2009 and 2010 (because the individual's center of living is outside Israel), the individual is not considered an Israeli resident retroactively for 2007 and 2008, provided that the individual spent less than 183 days in Israel in those years.

New immigrants are generally classified as Israeli residents for Israeli tax purposes. However, they may enjoy certain income tax, capital gains tax and import tax benefits for specified periods. For new immigrants and long absent returning resident (people who return to Israel after at least 10 years abroad) there is an exemption of 10 years. For other returning resident (people who return after at least 6 years abroad but less than 10 years) there is an exemption of 5 years on current profit and 10 years on capita gains.

### Income subject to tax

**Employment income** - Taxable employment income broadly covers salary and virtually all cash, in-kind benefits and allowances provided directly or indirectly to employees or for their benefit. If benefits are provided on a net-of-tax basis, they must be grossed up for tax purposes.

**Self-employment income** - Residents and non-residents generally are subject to Israeli income tax on income derived from a business conducted in Israel and on income from one time commercial transactions. Residents are also subject to tax

on overseas income.

Self-employed individuals are subject to tax on business profits at the rates set forth in rates.

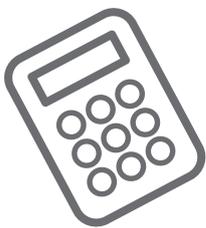
**Investment income** - Varying tax rates apply to investment income (interest, dividend and capital gain) derived by individuals, depending inter alia, upon the type of investment income, instrument and percentage shareholding.

**Taxation of employee share option plans and share purchase plans** - Detailed rules apply to employee share option plans and share purchase plans.

**Special rules for expatriates** - If no treaty exemption applies, expatriate non-residents working in Israel lawfully for an employer may enjoy certain benefits.

**Rates** - In principle, Israeli personal tax liability is computed annually, although tax is typically withheld from salaries and reported each month. Monthly tax brackets used during a year for payroll and other purposes are updated annually for inflation and are totaled to produce the annual tax brackets. For the 2015 tax year the maximum rate of personal income tax is 48%. Additionally, as from January 1, 2013, supplementary tax at the rate of 2% is levied on income exceeding NIS 810,720 (year 2015).





# Corporate taxation

## R&D and innovation Incentives

The State of Israel encourages and supports industrial R&D through the Office of the Chief Scientist (OCS) at the Israeli Ministry of Industry, Trade and Labor. The role of the OCS is to assist in the development of new technologies in Israel, as a mean of fostering the Israeli economy, encouraging technological entrepreneurship, leveraging Israel's science-skilled resources, supporting high added value R&D, enhancing the knowledge base of Israeli hi-tech/bio-tech/cleantech industries and promoting cooperation in R&D both nationally and internationally.

The OCS supports companies at all their different development stages from pre-seed/seed and start-up to mature technology stages. The OCS provides a variety of support programs tailored for each stage that operate on an annual budget of approximately USD400 million. These programs have promoted the Israeli industry to become one of the world's foremost technology centers. Companies that received funding from the OCS are subjugated to the Israeli R&D law and related regulations.

The funding instruments are divided into local programs and international collaboration programs.

### Pre competitive R&D

- ▶ **Noffar program** is designed to support applied academic research in themes/topics in the fields of biotechnology, nanotechnology, medical device, technologies of water accumulation, energy transposition and multi-disciplinary area in order to approve the feasibility of a technology in the academia.

The objective of this program is to reach significant milestones at the end of the project, which will enable the industrial partner sign a contract with the Academy for the Commercialization of the Technology.

Grants under this program constitute up to 90% of the budget approved by the OCS (up to USD115,000). There are no royalty payments under this program.

- ▶ **Magnet consortium** supports the formation of consortia made up of industrial companies and academic institutions, in order to jointly develop generic, pre competitive technologies. Grants under this program constitute up to 66% of the budget approved by the OCS with no royalty payments
- ▶ **Generic R&D** is a program encouraging large companies investing heavily in R&D to invest in long-term generic R&D. Grants under this program constitute up to 50% of the budget approved by the OCS.
- ▶ **Nitzan Fund** - for encouragement of technological collaboration between the research institutes and Israeli companies in the fields of Agriculture. The objective of Nitzan fund is to elaborate the applied research, in the different Agriculture fields, which haven't been acknowledged by the industry as having commercial potential. This program offers budget approval for a maximum of 18 months and a grant of up to 90% of the approved budget.

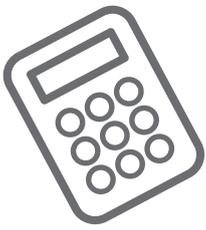
### Pre seed & seed R&D

Grants under this program constitute up to 90% of the budget approved by the OCS (up to USD140,000). There are no royalty payments under this program.

- ▶ **Magnetron program** promotes technology transfer from academic institutions to industry via mutual cooperation between a company and an academic research program. The program offers support for pre-competitive, generic stages of development. Grants under this program constitute up to 66% of the budget approved by the OCS. There are no royalty payments under this program.
- ▶ **Tnufa fund** a fund for pre-seed entrepreneurs and startups that wish to bring a novel technological idea to business fruition. The support is granted subject to producing proof of technological feasibility and business viability of the idea in question in an aim to promote the project to a stage in which significant funds may be raised for the continued development and commercialization. The support granted at the lower rate of up to 85% of the budget or USD 50,000.
- ▶ **Technological incubators** provide a framework and support for nascent companies to develop their innovative technological ideas and to help them raise private capital and turn into a commercial company. Each incubator provides suitable facilities for R&D activity & administrative and logistic support to projects for a maximum period of 2 years (3 years for biotechnology companies). Grants are awarded up to 85% of the approved budget to a maximum of USD500,000.
- ▶ **Pre-seed companies** pre-seed companies that have yet received any OCS support (other than in the technological incubator programs or the TNUFA Fund) and that have raised relatively small amounts of capital from private investors are eligible for support at a rate of 50% of the approved budget. Among others, this program enables obtaining the OCS' contingent approval for the development program before the supplementary capital needed for conducting the project is raised. This program offers budget approval for a maximum period of 24 months.

### Competitive R&D

- ▶ **The R&D Fund** supports applied R&D projects. To be approved by the OCS, the R&D program must show significant technological innovation leading to a new product and marketing potential. Grants are awarded on a sliding scale from 20% to 50% of the total approved R&D expenditure. In a commercially successful product developed in the program, a royalties payment of 3% to 6% from the product sales will be paid until recovering the full amount received in the program.
- ▶ **Traditional industry support program** offers funds for projects from traditional industries based on innovation. Grants under this program constitute up to 50% of the budget approved by the OCS and currently, the grants under this program are not subject to royalties.



# Corporate taxation

- ▶ **H2020 SME instrument** program supports new technology development and innovation of small and medium companies in Israel and Europe. Grants are close to 100% of the total approved budget and up to 2 million Euros.
- ▶ **KIDMA** - an aid program designed for cyber-security companies which offers preferred competitive terms that include a grant of up to 50% of the approved budget and participation in marketing expenses. Budget approval may be obtained for this program for a maximum period of 24 months. If a commercially successful product is developed in the program, a royalties payment of 3% to 6% from the product sales will be paid until recovering the full amount received in the program.
- ▶ **The space program** - a program designed to encourage R&D for finding various space related technological solutions such as business space R&D and development or upgrading of space related products. This development program cannot exceed a period of 36 months with maximum financial aid offered in an amount of USD 5 million (50% of the approved budget for large companies and 60% or 85% for small companies).
- ▶ **MEIMAD** - a support program aimed at encouraging the development of dual use technologies that can benefit the State's national security and at the same time form a basis for potential global civilian and military marketing. The maximum per project is NIS 5 million and the grant rate is 50%-66% for industrial companies and 50%-90% for research institutions. The program is operated in the framework of the MAGNET instruments and the OCS in collaboration with the Ministry of Defense's Administration for the development of weapons and technological infrastructure. Programs that consist of the transfer of technology from research institutions to Israeli companies are exempt from paying any royalties.
- ▶ **Bi-Lateral R&D agreements** are programs that fund Israeli R&D companies collaborating with foreign companies. Grants under this program constitute up to 50% of the budget approved by the OCS and subject to royalty payments. The program is active with countries that signed a bi-national R&D collaboration agreement with the Israeli government. Relevant locations include European countries: Denmark, Finland, France, Germany, Italy, Slovenia, Spain, Sweden, Czech Republic, Switzerland, Greece, Hungary, Poland, Romania, Russia, UK and Turkey; Far East countries: China, India, Taiwan, Victoria (Australia); North American states: Maryland, Wisconsin and Virginia; South American countries: Brazil, Uruguay and Argentina.
- ▶ **Horizon2020** is the new European Union's Framework Program for Research and Innovation. This program is expected to supersede the EU Framework Program 7 which ended by consolidating the three main R&D initiatives and financing resources:
  - ▶ **The Framework Program;**
  - ▶ **The CIP** (Competitiveness and Innovation Framework Program); and
  - ▶ **The EIT** (European Institute of Innovation and Technology), with a budget of close to 72.3 billion Euros for a period of seven years, until 2020. Royalty free direct cash funding is available in a number of research and development sectors over the next several years. Broad categories include Transport, ICT, Energy, Environment, Health, Food, Agriculture, Security, etc. A few times a year the European Commission issues calls for projects within these categories. The framework program brings together industries and academic research. Israel is fully associated with the EU's Framework Program for Research and Development. Grants available to industrial partners and SMEs/Universities are 50% and 75% of the full cost and overheads, respectively.
- ▶ **The Global Enterprise R&D Cooperation Framework** is a program attracting prominent multinationals to forge investment cooperation deals with Israeli startups. The program is flexible by tailoring each agreement to the requirements of the multinational company. Government support provides opportunity for Israeli startups to gain access to multinational corporations that are participating in the program, while international giants in turn gain access to innovative technologies. Grants are up to 50% of the budget approved by the OCS and subject to royalty payments.

## International collaboration programs

consist of multinational and bi-national programs

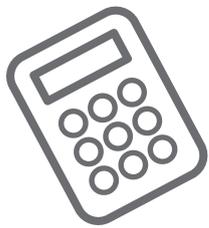
### Multinational programs

- ▶ **Eureka** is a pan-European network for market-oriented, industrial R&D. These projects enjoy access to national funding sources - Israeli companies participating in the program are entitled to receive R&D grants from the OCS. Grants under this program constitute up to 50% of the budget approved by the OCS and subject to royalty payments. Eureka currently counts 39 member countries. Eureka includes a few sub programs: individual R&D projects support of collaboration between companies from different countries; Eureka 'Clusters' supports a group of companies in pre defined technological areas; Eurostars Program supports collaboration between small and medium sized entities; Umbrellas are thematic networks which focus on a specific technology area or business sector.

### Bi-national funds

Bi-national funds enable Israeli companies to participate in joint R&D projects with foreign counterparts. Four funds are currently operating in Israel:

- ▶ **BIRD US** - Israel Bi-national research and development generates mutually beneficial cooperation between the US private sectors and Israeli industries. BIRD provides funding covering up to 50% of project development and product commercialization costs up to USD1,000,000. BIRD Energy provides specific grants for US - Israel joint renewable



# Corporate taxation

energy developments. The projects are funded by the US Department of Energy (DOE), the Israeli Ministry of National Infrastructures and the BIRD foundation. The repayment of the grant is based on royalties of the successfully commercialized product.

- ▶ **CIIRDF** (Canada-Israel R&D Foundation) promotes and supports collaborative R&D between firms in both countries. CIIRDF's support includes funding of up to 50% of the eligible R&D costs and up to CAN\$800,000. The repayment of the grant is based on royalties of the successfully commercialized product.
- ▶ **KORIL** (Korea-Israel Industrial R&D Foundation) promotes and supports collaborative R&D between firms in both countries. The financial support for the joint R&D projects is divided into three categories - feasibility study; mini-project and full scale project. In the case of a full-scale project, support can reach a maximum of 50% of the allowed joint R&D expenditure, up to a ceiling of USD1,000,000. The repayment of the grant is based on royalties of the successfully commercialized product.
- ▶ **SIIRD** (Singapore-Israel Industrial R&D Foundation) promotes, facilitates and supports joint industrial research and Development projects between companies from Singapore and Israel. SIIRD funds joint R&D projects undertaken by companies from Singapore and Israel, up to 50% of eligible R&D project costs. Grants can reach a ceiling of USD1,000,000 (not more than USD500,000 in one year). The repayment of the grant is based on royalties of the successfully commercialized product.

## Incentives for Cleantech companies

Programs by the Ministry of Energy and Water - the Chief Scientist of the Ministry of Energy and Water is in charge of R&D support programs. Annual programs:

- ▶ **Pilot projects** - support of projects for testing and examining innovative technological components before commercial application. Preference will be given to international collaboration projects with real benefits of project promotion and/or program commercialization. Projects for reducing oil dependency in the transportation and energy sectors will be supported. A grant of 50% of the approved budget up to USD 387,000 will be provided.

- ▶ **Heznek Fund** - a program for proof of technological feasibility or business viability of an idea for the development and manufacture of a new product or the development of a new process, or for significant improvement of an existing product or process, provided that the product or process are in the fields of alternative energy, renewable energy, oil alternatives or energy efficiency. The ideas must contain components of technological development, be solidly formed and have firm scientific foundations. The Ministry offers support at a rate of 62.5% of the approved budget up to USD 150,000.
- ▶ **Projects for installing energy efficiency technologies** - participation in costs of installing energy efficiency technologies. Grants will be provided to energy consumers (industrial, public, commercial) which will install technologies that are included in the list of approved technologies (including water cooling units, air compressors, residual heat utilization systems and lighting fixture upgrades) and will be able to demonstrate compliance with specific saving targets. The grant amount is up to USD 75,000 per project.
- ▶ **Support in financing costs of connection to the natural gas distribution grid and in financing costs of conversion of internal systems to natural gas operation** - support is offered to gas consumers that connect to the natural gas distribution grid in specific areas and are defined as medium/large consumers (whose expected annual natural gas consumption exceeds 100,000 cm a year and are defined as medium/large consumers in the natural gas distribution agreements they signed with the license owners). The grant rate ranges from 50% to 75% of deductible expenses up to a maximum amount of USD 150,000.

\* Portions of information mentioned in this book were based on data published by the Ministry of Industry, Trade & Labor and the Ministry of Finance.





# Financial reporting & auditing

## Statutory requirements

### Books and records

Under the Companies Law, 1999, companies must maintain accounting records concerning the following:

- ▶ Payments and receipts
- ▶ Purchases and sales of goods
- ▶ Assets and liabilities

Proper accounting records are those that meets the following requirements:

- ▶ They present and explain the company's transactions and its financial position
- ▶ They contain sufficiently detailed daily records of all cash payments and receipts
- ▶ They present the total annual inventories and, in most cases, changes in inventories, with details concerning buyers and sellers

In addition to proper accounting records, a company must maintain various auxiliary records (statutory books), such as lists of shareholders, records of liens and minutes of the meetings of its shareholders and board of directors.

In principle, the accounting records may be maintained in another country. However, in practice, they should be immediately available in Israel for tax purposes.

### Financial statements

Under the Companies Law, 1999, all companies, including privately owned companies, must file audited annual financial statements with the Registrar of Companies.

In addition, all companies must file audited financial statements with the tax authorities. Private companies must present financial statements to their shareholders, either together with the notice of the general meeting or on request. Information contained in these statements generally does not receive wide public distribution. However, banks, certain financial institutions and insurance companies must publish their financial statements in daily newspapers.

Public companies with securities traded on the Tel-Aviv Stock Exchange must prepare and publish full audited annual financial statements and reviewed quarterly financial statements since 2008 in accordance with International Financial Reporting Standards ("IFRS"). Under the Israeli Securities Regulations, public companies must provide additional disclosures in their annual and quarterly financial statements.

If a company is considered a material associated company of a public company, its financial statements must be attached to the financial statements of the public company.

## Sources of accounting principles

### International accounting standards board

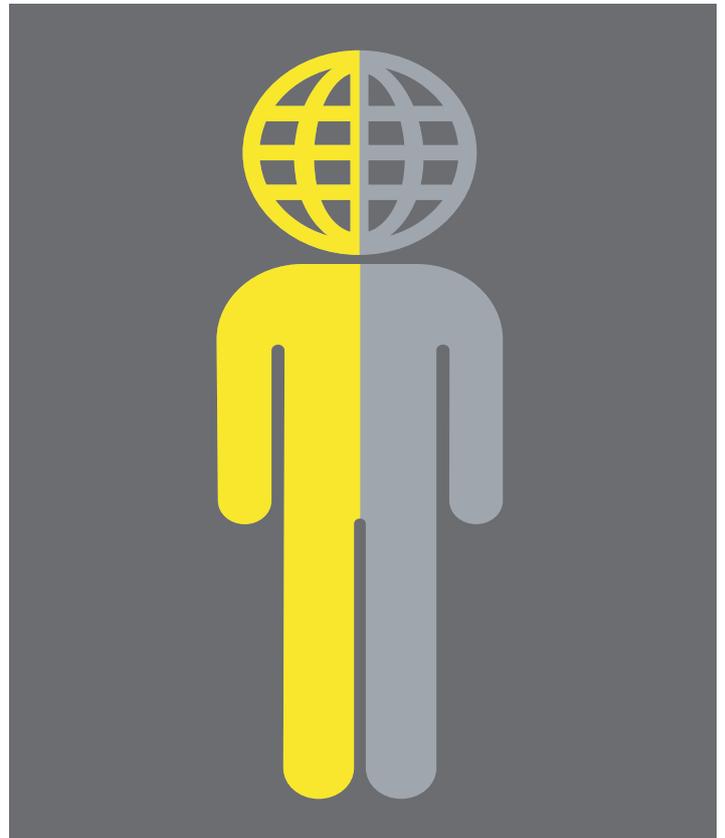
Since 2008, all public companies' financial statements both annual and quarterly, including certain financial institutions and insurance companies, excluding banks, must comply with the IFRS. The conversion date for reporting under International Financial Reporting Standards was January 2007.

Israeli banks apply generally accepted accounting principles based on the guidelines of the Supervisor of Banks. These guidelines are based on United States generally accepted accounting principles and for non-financial items IFRS is applied.

### Israeli standards

Generally accepted accounting principles that are authorized by the Israeli Institute of Certified Public Accountants ("The Institute") must be applied in the preparation of the financial statements of privately held companies.

Private companies may elect to report in accordance with IFRS or Israeli Standards. In recent years, as part of the conversion to IFRS, the opinions that were published were in all material respects identical to International Accounting Standards.





# Financial reporting & auditing

## Financial reporting

### Basic requirements

The Companies Law, 1999, prescribes the basic requirements for the preparation of annual financial statements and the presentation of the financial statements to the general meeting of shareholders.

The directors of the company are responsible for the preparation of the financial statements. The balance sheet must be signed on behalf of the directors. The signature indicates the approval of the board.

### Public companies

Public companies must issue an annual report within three months after the end of the year. Other than the fourth quarter, public companies are required by the Securities Law to issue quarterly reports within two months after the end of a quarter. These quarterly reports must be reviewed by the independent accountants of the company.

The Securities Law requires management discussion and analysis in annual and quarterly reports of public companies.

### Audit requirements

All companies must file audited financial statements with the Registrar of Companies and the Tax Authorities.

Israeli auditing standards are prescribed by the Israeli Institute of Certified Public Accountants and are incorporated into the Auditors (Mode of Performance) Regulations, 1973.

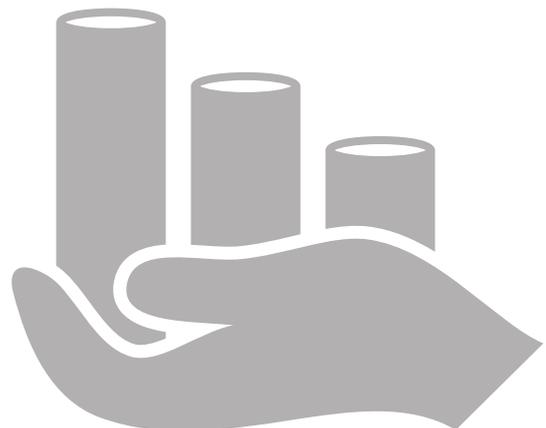
The Israeli institute is a member of the International Federation of Accountants (IFAC); the auditing standards published by the Israeli institute are based on international auditing standards.

The auditors' report must state that the financial statements are in accordance with the books of the company and must include the auditor's opinion as to the fair presentation of the affairs of the company. In general, an opinion on the financial statements must be signed by a certified public accountant.

### The Goshen Committee

In August 2004, the Israel Securities Authority ("ISA") appointed a committee (named the Goshen Committee) to examine corporate governance in Israeli public companies. The Committee placed great importance on setting proper corporate governance standards that are generally aligned with standards adopted under the Sarbanes-Oxley Act of 2002 ("US SOX"). ISA published regulations, regarding the effectiveness of internal controls over financial reporting and disclosures ("ICFR") in December 2009. ICFR is based upon performance of a risk assessment of the company's financial statements. This "top-down-risk-based approach" is part of the scoping method used by company management to identify very material processes ("VMPs"). The ICFR model incorporates four main components: Entity - Level Controls ("ELC"), Information Technology General Controls ("ITGC"), Financial Statement and Disclosure Controls and Controls over VMPs. Controls within the VMPs include only those

controls which have an influence in recorded transactions on the company's books and records as reported to the TASE (Tel-Aviv Stock Exchange). The ICFR regulation applies only for big public companies. Small public companies do not require including an auditors opinion on ICFR, but only a CEO and CFO opinion on ICFR. Banks and insurance companies require to report on ICFR according to US SOX regulations.





## EY Israel

We are one of the largest accounting firms in Israel specializing in assurance, tax, advisory and transactions. With approximately 1,800 employees, we provide services to large corporations, multinational companies, public companies traded in Israel, the majority of Israeli companies traded in the US and in Europe, medium-sized and small companies and most of the Israeli start-up companies.

## The client comes first

We, at Kost Forer Gabbay & Kasierer - EY, understand that the client is our most important asset and therefore we offer a variety of customized solutions. The services are rendered at a high professional level, collectively under one roof, and consist of audit services, business and transaction advisory services, local and international taxation, mergers and acquisitions, government incentives and more.

In order to meet the client's needs in the best possible manner, we operate based on various business segments in the firm's principal areas of expertise:

- ▶ Financial services: insurance companies, banks, provident funds, trust funds
- ▶ Technology, communications & media
- ▶ Life sciences, biotechnology & medical devices
- ▶ Real estate
- ▶ Oil & gas
- ▶ Consumer products & retail
- ▶ Investment funds
- ▶ Industry
- ▶ Non-profit organizations
- ▶ Infrastructures
- ▶ Cleantech

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## Our four core services

We provide core services in four major areas:

- ▶ Assurance
- ▶ Tax
- ▶ Transactions
- ▶ Advisory

Via these services, we assist thousands of clients in various industries and accompany them in dealing with the intricate and dynamic structures of their business segments.

\* All services are provided as long as they are in compliance with the independence rules.

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In addition a portion of the information presented in this publication was based on data published by the following organizations:

- ▶ Ministry of Finance The International Affairs Department
- ▶ Israel Ministry of Foreign Affairs
- ▶ Trading Economics
- ▶ Tel-Aviv Stock Exchange
- ▶ Central Intelligence Agency
- ▶ Ministry of Industry, Trade and Labor
- ▶ Invest in Israel Investment Promotion Center
- ▶ World Bank

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