

CLIENT UPDATE

Classification of Foreign Companies as Residents of Israel for Tax Purposes

Dear clients, colleagues and friends,

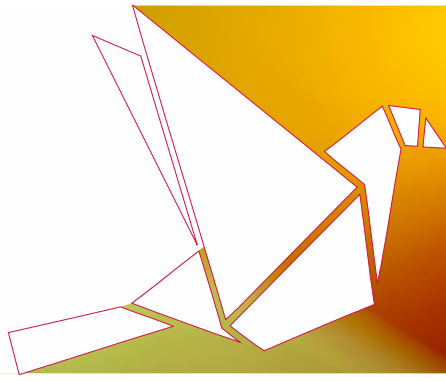
This is an important update regarding proposed legislation that would classify foreign companies as residents of Israel for tax purposes.

1. Background

The Budget Bill for 2017 – 2018 which was recently approved by the Government includes far-reaching proposed legislative changes in the field of international taxation, including expanding the “management and control” test used to treat foreign companies as residents of Israel for tax purposes. If enacted, the legislation would come into effect beginning January 1, 2017. At this stage it is not yet final legislation.

2. Determining Corporate Residency for Tax Purposes under Existing Law

Pursuant to the applicable tax regime in Israel, an Israeli resident company is taxed on its worldwide income. Under existing law, a company is treated as a resident of Israel for tax purposes if it is incorporated in Israel or if the control and management of its business is conducted from Israel (the so called “management and control” test). Israeli courts have determined that a technical and formal examination of management and control through holding of shares or rights in the company is not sufficient, but rather, a more material investigation is needed to identify the place where the business policy of the company is set, and the place where the strategic decisions of the company are made.



3. The Proposed Legislation

A. Expansion of the “management and control” Test for Treating Foreign Companies as Residents of Israel for Tax Purposes

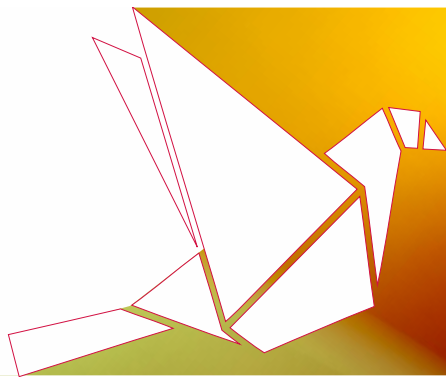
The proposed legislation introduces two rebuttable presumptions, pursuant to which a foreign company would be deemed managed and controlled from Israel, if Israeli residents control the foreign company or are beneficiaries of, or entitled to, directly or indirectly, 50% or more of such company’s revenues or profits and the final tax rate applicable to the foreign company’s profits is 15% or less. In addition, the foreign company must meet one of the following:

- It is a resident of a country which has not signed a tax treaty for the prevention of double taxation with Israel
- It is a resident of a country that does not impose taxes on income generated outside its territory

The significance of broadening the management and control test by adding these presumptions is dramatic, since it may result in the classification of foreign companies as residents of Israel for tax purposes. Such companies would be subject to tax on their worldwide income, would be subject to withholding obligations with respect to various payments they make, and would need to comply with reporting obligations to the Israel Tax Authority.

B. Reporting Obligations of Companies Taking a Position that the Presumptions do not Apply

The proposed legislation introduces a reporting obligation with respect to companies that take the view that they are not residents of Israel for tax purposes, despite the fact that the said presumptions apply. Such reporting obligation would assist the



Israel Tax Authority in identifying such companies for the purpose of conducting audits.

In view of this proposed legislation, we recommend that the tax residency of foreign companies and existing tax structures be examined, particularly with respect to companies incorporated in offshore countries or in countries where the applicable corporate tax rate is 15% or less. We recommend taking such actions in 2016 while the proposed legislation has not yet entered into force.

We will be happy to answer any question or clarification on this matter. We will continue to monitor developments with respect to the Budget Bill and update accordingly.

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