

Participation Exemption in Israel

Shai Dover, C.P.A.(Isr.)

Participation Exemption is an exemption given to a foreign resident operating his business in one state via a company based in another. The state through which the foreign resident operates his business does not tax his companies' profits. The foreign resident benefits from his exempt business center, whereas the hosting country benefits from the expenses related to a business center, such as office rent, wages paid, etc.

The law in Israel serves the purpose of establishing a center of international activity in a comfortable tax regime and an advanced western state that offers every service an international business man needs.

Israel's` participation exemption law is arranged in such a manner that western state will not claim that the law could be misused for the sake of tax evasion in the resident country.

Israeli Holding Companies

An Israeli Holding Company is a company that fulfills a few conditions. The following conditions are the main:

1. The company is founded in Israel and managed from Israel.
2. Its investment in subsidiaries is at least 50,000,000 NIS (approximately \$11.2 million U.S dollars).

Subsidiaries

The definition of an IHC encloses the word "subsidiaries". A "Subsidiary" is a company that fulfills a few conditions. The following conditions are the main:

1. It is resident in a country that has a tax treaty with Israel, or that has a corporate tax rate of 15% or more.
2. At least 75% of the company income is business income (the definition of business income in Israel is based mainly on court rulings).

Exemptions for the Israeli Holding Company

The IHC will be exempt from taxes on the following incomes:

1. Dividends received from subsidiaries.
2. Capital gains from sale of the subsidiaries shares.

Dividend for IHC to foreign resident share holders

The law is short and clear in regard to foreign resident: "A dividend received by a foreign resident share holder from an Israeli Holding Company will be taxed at the rate of 5%".

Pre ruling

The new law provides that any foreign resident can file a request for a pre ruling decision. It is possible to receive a ruling decision for the activity of an IHC as well.

Summery

An Israeli holding company is recommended for foreign residents who wish to do business in states that have a tax treaty with Israel.

The new law for participation exemption offers foreign residents a tax exemption for their Israeli company and a

tax rate of 5% on distribution of the profits as dividends.

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 and other various tax matters.

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