✓Artzi & Hiba -
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Tax News Alert

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July 13, 2011
Tax News Alert No. 11

Dear Friends and Clients We are pleased to update you with selected Israeli tax development for the second quarter of 2011

Selected Issues:

- Reduction of Corporate and Individual Income Rates in 2012 to be Frozen.
- Revoking Exemptions to Non-Israeli Residents On Capital Gains and Interest Arising From Securities.
- A Proposed Reform in Real Estate Taxation in Israel.
- Incentives For Building Rental Housing

Sincerely,
Artzi & Hiba Tax Solutions Ltd.

Tax News Alert No.11 - July 2011

Dear friends,

The Artzi & Hiba firm is committed to the highest level of services. We keep our clients and colleagues, in Israel and abroad, fully up to date with respect to recent developments in the Israeli tax law and their implications.

We would like to thank you for using our services and for your kind cooperation which enables us to offer you high level tax solutions. It would be our professional, as well as our personal, honor to continue cooperating with you.

Reduction of Corporate and Individual Income Tax Rates in 2012 to be Frozen

Within the Economic Efficiency law of 2009, a gradual reduction in both corporate and individual income tax rates was established. Accordingly, the corporate tax was set to 25% in 2010, 24% in 2011, 23% in 2012 etc'. The final reduced tax rate was established to 18% in 2016. The top individual income tax bracket was to be gradually reduced until it reaches 39% in 2016.

On May 16, 2011 the Israeli parliament's (the Knesset) Finance Committee concluded that the corporate tax rates reduction (from 24% to 23%), planed for 2012 will be frozen, and thus **the corporate income tax will remain 24% during 2012**.

The reduction of individual income tax rate planed for 2012 will also be frozen, thus the **top tax bracket remains at the rate of 45%** on annual income exceeding 180,000 U.S. Dollars. It remains to be seen whether the planned reduction of income tax rates will be resumed in the future.

Revoking Exemptions to Non-Israeli Residents
On Capital Gains and Interest Arising From Securities

On June 15, 2011 the Israeli government published amendments to 3 regulations, thus revoking certain tax exemptions available to foreign residents. **Accordingly, the exemptions given to foreign residents on interest and capital gains derived indirectly from State loans traded in the Israeli stock exchange** (bearing a maturity date not exceeding 13 months from the date of issue) **are revoked, effective as of July 7, 2011.** Following this date, such gains will be subject to tax at a rate of 15%, 20% or corporate income tax, as applicable. The rates may be lower according to a tax treaty.

The Israeli tax authority (ITA) has explained that those exemptions (as well as other exemptions relevant to investments in Israeli capital market), were intended to encourage foreign residents to invest in the Israeli capital market. Recently, it became clear that such exemptions were being used by players on the foreign exchange market for realizing short-term profits. Such activity caused currency appreciation that may impair the long term competitiveness of the Israeli market, mainly regarding short-term Bank-of-Israel notes ("Makam") and short-term Government bonds. This trend has increased its volume in light of the increase in the interest rate in Israel and the rising gap between the NIS and different foreign currency exchange rates.

Around that time, another bill was proposed (No. 186 to Income Tax Ordinance). This bill is intended to amend Article 97(b2) of the ITO, by revoking the current tax exemption granted to foreign residents on gains arising from direct sale of short term state loans and traded securities in the Israeli stock market.

If enacted, **this change should not affect sellers who are residents of states with which Israel has signed a tax treaty for the avoidance of double taxation, as long as such treaty allocates the right to tax capital gains arising from selling securities to the state of residence**.

However, this change may cause practical discomforts to foreign investors, since the Israeli financial institutions will request the ITA's approval in order to avoid withholding tax on such gains. If such approval is not presented to the bank, it will withhold the tax and the investors would have to apply to the ITA for a refund.

A Proposed Reform in Real Estate Taxation in Israel

In our previous tax alert (No. 10), we have reviewed the Israeli government's measures aimed to increase the supply of residential apartments/homes, as presented in the Real Estate Taxation Act (increasing the supply of residential apartments - Temporary order), 2011.

According to a Memorandum of a Bill proposal that was recently published, the entire tax exemption system for gains (land betterment) derived from the sale of residential apartments/homes located in Israel, **is expected to change dramatically as of 1.1.2013**.

Basically, the tax exemption for gain deriving from the sale of one residential apartment/home, at any given period of time, will remain (provided it was actually used as a dwelling place).

As for residential apartments acquired prior to the publication of the suggested law, the built-in gain will remain exempt from tax. Hence, the gain will be apportioned to "the exempted period" (date of purchase until the publication of the suggested law), with respect to the entire holding period. A taxable gain will be subject to a flat rate of 20%.

Another provision included within the memorandum of bill, provides a tax exemption for gain deriving from the sale of an apartment that is being used at present as an office space. The exemption will only apply if the apartment is sold by the end of 2012 and as long as it will actually be used as a dwelling place for at least 2 years following the sale. This exemption is restricted for 3 apartments and may preclude the exemption granted according to the temporary order (reviewed in tax alert no. 10)

It is important to stress that, at this stage, only the memorandum was published rather than an actual proposal of a bill. **Nevertheless, considering the temporary order and recent positions taken by the Israeli Minister of Finance, the message for both Israeli and non-Israeli investors is pretty clear - if you wish to have a built-in gain exempt from Israeli tax, you better consider selling your apartment soon!**

The content of this Tax News Alert should not be regarded as a tax opinion, an examination of the relevant laws, or as professional consultation, but only as a general and a high- level briefing of selected issues.

Any implementation, which is based on the information provided herein, should only be performed after obtaining professional and specific consultation.

Incentives for Building Rental Housing

Rental housing is an essential social and economic goal, and it is for a good reason that the Israeli legislator wishes to encourage this sector. Chapter 7-1 of The Law of Encouragement of Capital Investment provides for tax benefits to encourage the establishment and operation of buildings comprising of rental apartments (hereinafter: "**Rental Apartments Building**"). Following is a review of tax benefits available with respect to **new** rental apartments buildings, e.g. such building approved as of January 1, 2009:

- **Reduced income tax rates-** 11% for companies, 20% for Individuals. Such rates apply to the actual gain from the sale of apartments (including apartments that were not rented) and to rental income.
- **Dividend-** 15% tax is chargeable on dividend distributed from the earnings of an approved enterprise of a rental apartments building. This rate may be lower according to a tax treaty.
- **Accelerated Depreciation-** at the rate of 20% per year.
- **VAT-** exemption from VAT on the sale of apartments and rental income.

In order to qualify for such benefits, a rental apartments building has to meet certain conditions. Those include a minimal rented area, minimal rental period and compliance with monthly rent income limit.

Recently, the Investment Center Administration has issued an update regarding the conditions that have to be met as follows:

- The tax benefits are restricted to an average monthly rent of 6,200 NIS. (The total rent fees in the building, including rent fees from non-eligible apartments, are divided by the number of apartments in the building).
- In case the average monthly rate exceeds 6,200 NIS (app' 1,800 US dollars) up to 8,000 NIS (app' 2,290 US dollars) - the tax benefit shall only be granted with respect to 6,200 NIS.
- In case the average monthly rate exceeds 8,000 NIS the benefits are denied.

The new changes provide for tax benefits with respect to buildings and offer the possibility to receive benefits for rental income with respect to apartments in the center of the country, thus turning this law into an attractive investment option.

In case you have any questions or need further clarifications please do not hesitate to contact our International Taxation Team:
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