

Investment Incentives in Israel

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PRACTITIONERS' CORNER

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The corporate income tax rate in Israel is 27 percent,¹ yet many companies, especially those held by foreign investors, may enjoy favorable tax incentives that can eliminate or substantially reduce the tax rates. This article outlines the various tax incentives granted under the Law for the Encouragement of Capital Investment (the investment law), as well as the necessary requirements to enjoy these incentives.²

Investment incentives are outlined in the investment law, which has been recently revised;³ the law seeks to attract capital to Israel, boost regional development, and create employment. The incentive programs can be divided in two main categories: the grants program, administered by the Israel Investment Center (a department of the Ministry of Industry, Trade, and Labor),

and the automatic tax benefits program, administered by the Israel Tax Authority.⁴ This article focuses on the latter program.

To qualify for the investment incentives, investment projects must meet the criteria described below. Once these criteria are met, the enterprise gains an “approved enterprise” status from the Israel Investment Center if it chooses the grants program, and a “beneficiary enterprise” status from the Tax Authority if it chooses one of the tax benefits programs.

A significant development in the investment law is the determination that the tax benefits do not require the prior approval of the Investment Center or the Tax Authority, and a company only has to meet specific criteria to enjoy the benefits. Once these criteria are met, the company may gain a beneficiary enterprise status from the Tax Authority. However, a company requiring prior approval to ensure certainty could, for a fee, file a request for an advance ruling to verify that it meets the criteria necessary to obtain the beneficiary enterprise status.

A beneficiary enterprise is entitled, in each year of the benefits period, to select the most appropriate tax incentive track. Three tax benefits tracks have been set: the alternative benefit track, the Ireland track, and the

¹The tax rate is to be reduced to 25 percent in 2010. The Finance Ministry is now proposing that it should be gradually lowered to 20 percent by 2015.

²There are various incentives and benefits available to investors in Israeli companies; the most important are exemptions from import taxes (for exported goods), deferred VAT payments (for exporters), various export financing guarantees and insurance, employment incentive payments, and research and development grants.

³The Law for the Encouragement of Capital Investment, 5719-1959, Amendment 60, published Apr. 11, 2005.

⁴See <http://www.tamas.gov.il/NR/exeres/9DF4F491-E41C-406F-8903-894F11A502E0.htm>.

strategic track. Each track confers a reduced tax rate according to the priority zone in which the enterprise is located.

Under the investment law, Israel is geographically divided into three regions, which have been declared national priority zones: A, B, and C. Enterprises located in zone A are far from central Israel, relatively economically weak, and entitled to the most preferential benefits. Zone A includes the Galilee, Jordan Valley, the Negev, and Jerusalem (for high-tech enterprises); zone B includes Lower Galilee and Northern Negev; and zone C includes the rest of the country.⁵

The Tax Benefits Tracks

The three tax benefits tracks are detailed below.

The Alternative Benefit Track

Under the alternative benefit track, companies may elect to forgo all government cash grants and receive instead a total exemption from company tax on undistributed profits for 10 years in zone A, 6 years in zone B, or 2 years in zone C. During the remainder of the benefits period (7 or 10 years), the applicable corporate tax rate will apply. This means a tax rate of 25 percent or at a lower rate if the company is a foreign investment company (FIC).

The law seeks to attract capital to Israel, boost regional development, and create employment.

The tax holiday provides an Israeli tax exemption so long as the profits generated in the exemption period are retained within the company. On distribution of exempt income, the distributing company will be subject to corporate tax at the rate of 25 percent or at a lower rate if the company is an FIC.

Ireland Track

This track is designated for companies located in zone A that seek to distribute dividends while maintaining a low company and dividend tax burden. This track provides for a 10-year term of corporate tax rate of 11.5 percent and for a tax rate of 4 percent on the distribution of dividends to foreign investors with no further company tax implications arising from the distribution of dividends (as is the case if the alternative benefit track is chosen).

⁵*Id.*

The enterprise's election of either the alternative benefit track or the Ireland track must be made while informing the Israel Tax Authority of the beginning year. Such election may not be altered during the entire benefits period.⁶

Strategic Track

This is a special alternative tax benefit track intended for strategic investments in Israel. This track allows for a corporate tax and withholding tax exemption during the benefits period, for both the company and its shareholders. An Israeli company will enjoy this benefit for a 10-year period; an FIC will enjoy the same benefit for a 15-year period.

This program is intended mainly for large multinational companies meeting the following criteria: annual turnover of at least \$3 billion, minimum investment of \$130 million in the project, and the investment must be located in zone A. The benefits include a corporate tax rate of 0 percent and a dividend tax of 0 percent.

The Israeli government may, in specific cases, reduce the minimum requirements in this track if the investment will produce material contributions to the Israeli economy.

Additional Requirements

A "beneficiary enterprise" must comply with all of the following requirements: It must be incorporated in Israel; its business must be controlled and managed in Israel; the company must have admissible books and file all reports as required by Israeli laws; the company must not be a "family company," a "transparent company," or a kibbutz; the company and its functionaries must not have been convicted of tax felonies during the 10-year period prior to the benefits period; and it must own a beneficiary enterprise.⁷

A beneficiary enterprise must meet all of the following terms: It must be a "globally competitive and industrial enterprise"⁸ in which a minimum qualifying investment (as defined below) has been made, and it cannot be an "approved enterprise." A globally competitive enterprise is an enterprise that complies with one of the following requirements:

- its main activity is biotechnology or nanotechnology;

⁶Israel Tax Authority, Income Tax Circular 2/2006 — Professional/Legal Section Regarding: Amendment 60 to The Law for the Encouragement of Capital Investment, published July 12, 2006.

⁷*Id.*

⁸It is not always clear when an enterprise is considered to be industrial. There are few cases on this subject; *Masada v. Pashmag*, Court of Justice Case No. 441/86, has set the main criteria determining when an enterprise is considered industrial.

- its revenue during the current tax year from sales in a specific market does not exceed 75 percent of its total revenue for that tax year; or
- 25 percent or more of its revenue during the current tax year is derived from sales in a specific market that has a population of at least 12 million.

Also, to receive beneficiary company status, the company must invest toward purchasing productive assets (for example, machinery and equipment) within three years ending at the end of the “beginning year” (the minimum required investment). In the case of a new factory, the minimum required investment is NIS 300,000. For expansion of a factory, the amount of minimum required investment is NIS 300,000 or the amount based on the formula shown in Table 1, whichever is higher.⁹

Table 1. Calculating the Minimum Required Investment for Factory Expansion

Value of Productive Assets in the Factory in the Tax Year Prior to the Year the Minimum Qualifying Investment Commences (in NIS millions)	Amount of Investment Required Expressed as Percentage of the Value of the Productive Assets
Up to 140	12%
140-500	7%
Above 500	5%

In addition to the above benefits, an FIC may enjoy additional tax benefits. An FIC is an industrial company in which foreign residents make the investments, and the company confers to the investors at least 25 percent of the rights in the company. The minimal required investment of the foreign resident in the company must be NIS 5 million.

The additional benefits the company may enjoy are a prolonged benefits period (exceeding the regular seven years) when the foreign investment exceeds 25 percent; a reduced tax rate of 10 percent to 25 percent; and no limitation on the period of the reduced tax on the distribution of dividends.

⁹Supra note 4.

Table 2. Reduced Tax Rates for FICs

Foreign Investment Rate	Corporate Income Tax Rate
Up to 49%	25%
49%-74%	20%
74%-90%	15%
Above 90%	10%

Other Benefits

Accelerated Depreciation

A beneficiary enterprise is entitled to “accelerated depreciation” on its property and equipment. During the first five-year period of operation, the company may depreciate its assets for tax purposes at 200 percent of the ordinary rate of depreciation for equipment and 400 percent of the ordinary rate for buildings. Depreciation on buildings will not exceed 20 percent per annum.

Base Turnover Reduction

Another substantial benefit a beneficiary enterprise may enjoy is the reduction of its “base turnover,” according to which the tax benefits are calculated. The term “base turnover” reflects the average turnover during the three years before the beginning year. According to the investment law, the relative part of the enterprise reflecting the base turnover will bear the regular corporate income tax rate. Therefore, the reduction of the base turnover means an increase of the beneficiary part of the turnover, which may enjoy the tax benefits.¹⁰

A beneficiary enterprise may reduce its base turnover at a rate of 10 percent for each tax year, as of the beginning year, provided that in each tax year the following two main criteria have been met:

- an annual investment of at least 7 percent of the turnover (of the tax year) has been made in research and development; and
- at least 20 percent of the enterprise’s employees are academics in the field of engineering, computers, or natural science. ◆

¹⁰See Deloitte Client Circular, “Regulations Regarding the Base Turnover Reduction of an Approved Beneficiary Enterprise” (in Hebrew), available at http://www.deloitte.com/dtt/cda/doc/content/Tax_18.pdf.

Table 3. Summary of Benefits

Location of the Enterprise	Track	Corporate Tax Rate — Benefit Period	Tax Rate on Dividend Distribution	Tax Rate Distribution of Exempt Profit	Benefit Period
Zone A	Alternative benefit track	Tax exemption	15%	10%-25% depending on the foreign investment rate.	10 years/15 years for a large FIC.
	Ireland track	11.5%	15% (4% regarding dividend distributed to foreign investors)	-	10 years/15 years for a large FIC.
	Strategic track	Tax exemption	Tax exemption	-	10 years/15 years for a large FIC.
Acknowledged Area	Strategic track	Tax exemption	Tax exemption	-	10 years/15 years for a large FIC.
Zone B		First 6 years: Tax exemption. Remaining years: 10%-25% depending on foreign investment.	15%	10%-25% depending on the foreign investment rate.	7 years/10 years for FIC/15 years for a large FIC.
Other		First 2 years: Tax exemption. Remaining years: 10%-25% depending on foreign investment.	15%	10%-25% depending on the foreign investment rate.	7 years/10 years for FIC/15 years for a large FIC.