Introduction

The Moore Stephens Europe *Doing Business In* series of guides have been prepared by Moore Stephens member firms in the relevant country in order to provide general information for persons contemplating doing business with or in the country concerned and/or individuals intending to live and work in that country temporarily or permanently.

*Doing Business in Israel 2017* has been written for Moore Stephens Europe Ltd by Lion, Orlitzky & Co, Moore Stephens Israel. In addition to background facts about Israel, it includes relevant information on business operations and taxation matters. This Guide is intended to assist organisations that are considering establishing a business in Israel either as a separate entity or as a subsidiary of an existing foreign company. It will also be helpful to anyone planning to come to Israel to work and live there either on secondment or as a permanent life choice.

Unless otherwise noted, the information contained in this Guide is believed to be accurate as of 1 October 2017. However, general publications of this nature cannot be used and are not intended to be used as a substitute for professional guidance specific to the reader’s particular circumstances.

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Our member firms’ objective is simple: to be viewed as the first point of contact for all our clients’ financial, advisory and compliance needs. They achieve this by providing sensible advice and tailored solutions to help their clients’ commercial and personal goals. Moore Stephens member firms across the globe share common values: integrity, personal service, quality, knowledge and a global view.

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## Contents

1. **Israel at a glance** 1  
   Geographical location and population 1  
   Language, religion and climate 1  
   Politics and government 1  
   Currency, time zone, weights and measures 1  
   General economic outlook 2  

2. **Doing business** 3  
   Main forms of business organisation 3  
   Introduction 3  
   Companies 3  
   Partnerships 4  
   Cooperatives 4  
   Not-for-profit organisations 4  
   Labour relations and working conditions 4  
   Employment legislation 4  

3. **Finance and investment** 6  
   Business regulation 6  
   Mergers and acquisitions 6  
   Monopolies 6  
   Intellectual proprietary rights 6  
   Banking and finance 6  
   Exchange controls and money laundering 7  
   Foreign Account Tax Compliance Act 7  
   Common Reporting Standard 7  
   Country-by-country reporting 8  
   Know your customer 8  
   Incentives to investment 8  
   Grants 8  
   R&D supportive fund 9  
   Grants 9  
   Participation in salary costs 9  
   Miscellaneous 9  
   Eilat free trade zone 9  

4. **The accounting and audit environment** 10  
   Accounting regulations 10  
   Audit requirements 10  
   Israeli Prospectus and European Legislation 11  

5. **Overview of the tax system** 12  
   Main taxes 12  
   Tax authorities 12  

6. **Taxes on business** 13  
   Corporate income tax 13  
   Scope and extent 13  
   Company residence 13  
   Taxable income and accounting basis 13  
   Deductions 14  
   Tax depreciation 14  
   Accelerated depreciation 15  
   Capital gains 15  
   Exemption for foreign residents 16  
   Retained profits 16  
   Dividends, interests and royalties 16  
   Losses 16  
   Group taxation 16  
   Withholding taxes 16  
   Thin capitalisation 17  
   Transfer pricing 17  
   Controlled foreign company (CFC) rules 17  
   Other significant anti-avoidance rules 17  
   Tax rate 18  
   International holding company régime (participation exemption) 18  
   Tax incentives 18  
   Preferred enterprises 18  
   Tax Compliance 19  
   Simplified taxation 19  
   Assessment procedure 19  
   Returns and payments 19  
   Appeals 19  
   Value added tax 20  
   Taxable entities 20  
   Taxable activities- standard, reduced and zero rates 20  
   Exempt supplies 20  
   Registration 20  
   Returns and payments 20  
   Transactions with traders in the PLO 20  

7. **Personal taxation** 21  
   Income tax 21  
   Residence 21  
   Structure of income tax 21  
   Taxable income includes 21  
   The family unit 21  
   Taxation of employment income 21  
   Salary withholding tax 22  
   Taxation of personal business income 22  
   Dividends 22  
   Interest 22  
   Royalties 22  
   Rental income 22
1. Israel at a glance

Geographical location and population
Israel is situated along the eastern coast of the Mediterranean, bordering Lebanon in the north, Syria in the northeast, Jordan and the Palestinian Autonomy West Bank in the East, and the Gaza Strip and Egypt on the southwest. Israel is about 430 km long and 110 km wide, and its terrain varies from hilly, mountainous landscape, with a rich agriculture in the north, to desert sites in the south. The lowest place in the globe, the Dead Sea, is situated in the south of Israel.

The main cities in Israel are Jerusalem, the capital of Israel and location of the Parliament and numerous historic and religious sites; Tel-Aviv, the financial, commercial and industrial centre of Israel and Haifa, the principal port city in the north of Israel.

Language, religion and climate
The official languages in Israel are Hebrew (the language of the majority Jewish citizens of Israel) and Arabic, both Semitic languages with their own alphabets. English is also widely spoken.

The majority religion in Israel is the Jewish religion. Arab citizens mostly belong to the Islamic faith, and there are also Christian communities. Jerusalem is a holy city for all three faiths.

Israel has a Mediterranean climate, characterised by long, hot and dry summers (June to September). Winters are short, mild and wet, except in the south.

Politics and government
Israel is a secular democracy whose unicameral parliament (Knesset), with 120 members, is elected through general elections every four years. Israel has an electoral system based on nation-wide proportional representation, and the number of seats that each party receives in the Knesset is proportional to its number of votes.

The head of government is the Prime Minister. This office has been held by Benjamin Netanyahu, head of the right-wing “Likud” (Union) party, since 2009. His latest government, formed after the Knesset elections in March 2015, is a coalition between Likud, the centrist Kulanu party and smaller right-wing and religious parties.

The function of the President of the State, who is elected by the Knesset for a five-year term, is primarily a representative one. The current President is Mr Reuven Rivlin, of the Likud party.

The judicial system is independent of the executive and legislative systems. The Supreme Court is the highest court of the State, serving both as the Highest tribunal of Appeal and the High Court of Justice (administrative law tribunal).

Israel's central bank, the Bank of Israel, serves as economic adviser to the government. It defines and implements monetary policy, controls local banks, manages the State's foreign currency etc.

Currency, time zone, weights and measures
The currency of Israel is the New Israeli shekel (ILS), divided into 100 agorot. As at the time of going to press (late February 2018), the new shekel was quoted at EUR 1 = ILS 4.2819 and USD 1 = ILS 3.4805

The Israeli time zone is GMT+2.

The prevailing system for measurement is the metric system.

Temperature is measured using the Celsius scale.
General economic outlook
The Israeli general economy is stable and mainly based on export.

In the 2nd quarter of 2017, the Israeli Gross Domestic Product (GDP) was ILS 313.520 million.

Israel enjoys a diversified economy. Services, particularly financial and business services, are the most important component of Israel’s economy. There are significant manufacturing activities in electronics, communications and other high-tech industries. Medium and lower-tech industries, such as chemicals, plastics and food are also important. Israel holds a comparative advantage in research and development (R&D) and benefits from government subsidies and massive investment in military R&D. Many global scale companies such as Google, IBM, Intel, Cisco, etc have R&D centres in Israel.

Because Israel has, relatively, no rich natural resources (although over the past few years, large gas deposits have been found on Israel coasts), it is necessary to import raw materials as well as many goods and services; the country depends on exports to pay for such goods and services. Israel’s main imports are raw materials (excluding fuel and raw diamonds), investment goods (heavy machinery and vehicles), fuel and diamonds. Leading exports are electronics, software and chemicals.

Israel became a full member of the OECD in 2010.

Israel offers a broad and solid infrastructure to entrepreneurs, investors and business people in all sectors. The Israeli banking system is modern, automated, highly computerised and a well-established component of the international banking system.

Diverse services required by businesses, such as insurance, legal, temporary manpower, communications, IT systems, marketing etc, are available in the most advanced formats.
2. Doing business

Main forms of business organisation

Introduction
Most of the legal entities in the modern Israeli business world operate under Israeli law. These legal entities include companies, partnerships, cooperatives and non-profit organisations.

Individuals may conduct business without establishing any separate legal entity.

Companies
The Companies Law 1999 regulates corporate activities. However, issues pertaining to liquidations, pledges and secured bonds are settled by the Company Ordinance.

The most common form of business entity in Israel is a limited-liability company with share capital.

A company may either be limited by share capital or unlimited, in which case the shareholders’ liability is unlimited.

No requirements exist regarding the nationality or residence of shareholders and company directors. In order to be incorporated, a company must register with the Registrar of Companies at the Ministry of Justice. An incorporated company is required, inter alia, to have Articles of Incorporation, which will state the company’s name, objects, the composition of the share capital and the number of shares, and will define the rules for managing the company and the relationship between the company and its shareholders.

There is no minimum required share capital.

The two common corporate forms are the private and public limited company, although there is a distinction between the two.

Public companies are companies whose shares are listed on a stock exchange or offered to the public in a prospectus and held by the public. These companies, whose shares are traded on the Tel Aviv Stock Exchange (TASE), are regulated by the Israel Securities Authority and are subject to all its requirements.

All other companies are private companies.

Foreign companies wishing to conduct business in Israel are required to register with the Registrar of Companies under the special status of ‘foreign company’. Foreign companies wishing to issue securities on the TASE are required to operate according to the TASE’s and Securities Authority’s requirements. These companies must have a local representative in Israel who is responsible for all the company’s activities in Israel with regard to reporting and taxation.
Partnerships
The Partnership Ordinance (New Version) 1975 governs the activities of partnerships. If a partnership is established for the purpose of conducting business in Israel, it is required to be registered with the Registrar of Partnerships at the Ministry of Justice.

A partnership may be composed of individuals or corporations. A partnership may not have more than 20 partners (except for a partnership of lawyers or auditors for engaging in their profession). A partnership is not required to file annual reports of any kind. However, all partnerships must register with the tax authorities and social security authorities as a separate entity.

A partnership can be general or limited. In a general partnership, each partner is responsible for the partnership's liabilities without limitation and is entitled to act on behalf of the partnership. However, in a limited partnership, the limited partners' liabilities are limited to the extent of their capital contribution. A limited partnership is required to have at least one general partner whose liabilities are unlimited.

Joint-ventures are not necessarily required to register as a partnership. However, for legal purposes, the partnerships ordinance dictates its own criteria for determining whether a joint-venture constitutes a partnership.

Cooperatives
The Cooperatives Ordinance governs the activities of cooperatives. Cooperatives are required to register with the Registrar of Cooperative Societies at the Ministry of Justice.

Members of a cooperative may be individuals or other cooperative societies.

Restrictions exist regarding membership in a cooperative society and the contents of the cooperative's Articles of Incorporation.

This type of entity is not very common and serves businesses mainly in the transportation and agriculture sectors.

Not-for-profit organisations
The vast majority of these entities function as amutot – non-profit societies or associations. The Registrar of Non-Profit Associations oversees the registration and activities of these organisations, defined by the following characteristics:

- Prohibition of profit distributions to association's members
- Restriction of the association's activities to those stated and authorised
- Prohibition of any sale or transfer of members' rights.

Labour relations and working conditions
Employment legislation
The work force in August 2017 totalled approximately 3.831 million employees in different sectors.

Salaries and wages paid to Israeli employees are highly diversified between the different sectors. The average salary stood in June 2017 at ILS 10,546.

The statutory minimum salary is set at ILS 5000 per month. The employee is also entitled to compensation for travel to and from his or her regular place of work.
In addition to salary, the employer is required to pay/contribute to various social benefits, as follows:

- **National Insurance (Social Security):** A weighted average of 5.475% of gross salary (in addition to the employee's contribution). The National Insurance Institute pays compensation in respect of unemployment, disability, retirement, military reserve duty, child allowances, maternity leave, etc. See further Chapter 9.

- **Severance pay:** an employee dismissed from his or her place of work is entitled to severance pay based on the latest salary amount for each year of employment.

- **Sick leave:** accumulation of 1.5 days per month. In many cases, the sick-leave allowance may amount to 18 days per annum. Employees may accumulate up to 90 sick days.

- **Annual leave:** Israeli law prescribes a minimum holiday period of two weeks annually. The holiday allowance is payable in addition to legal and religious holidays.

- **Pension Insurance:** All employees are entitled to pension insurance after six months of employment. Contributions by the employer and employee are set at a minimum rate of 6.5% paid by the employer and 6% paid by the employee. The employer's compensation contribution for severance is 6% and altogether a minimum of 12.5% paid by the employer.

- **Recuperation pay:** employees are entitled to recuperation pay according to seniority at work. The minimum amount for full time employees in the business sector is ILS 1890 per annum (5 days times ILS 378) and it may reach approximately ILS 3780 per annum.

There is a system of Industrial Tribunals to hear cases involving employment disputes, with provision for appeals to the higher courts.

**Work permits, visas etc**

In order to work in Israel for a period exceeding 30 days, a non-resident is required to obtain a work permit or hold a status other than ‘tourist’. To obtain work permits for prospective employees, Israeli employers are required to apply to the responsible ministry.
3. Finance and investment

Business regulation

Mergers and acquisitions
Under the Restrictive Trade Practices Act, notices of mergers and acquisitions must be filed with the Director-General of the Israeli Antitrust Authority in the following instances:

- where the transaction results in control of more than 50% of the production, sale, marketing or purchase of a product or service or group thereof, or
- the combined turnover in Israel of the entities involved exceeds ILS 150 million or
- where one of the entities involved constitutes a monopoly

A merger is defined as the acquisition of the principal assets of one entity by another or the acquisition of shares in such an entity involving control of more than 25% of the issued share capital, voting rights, rights to appoint directors or participation in profits. Mergers generally may proceed after the expiry of a 30-day filing period. The Israeli Antitrust Authority may issue a decision blocking the merger within that period if the merger creates a substantial likelihood that competition and a relevant market will be significantly harmed.

Monopolies
There are some regulations to prevent the abuse of a monopoly position. A monopoly is sometimes subject to price regulation. However, this measure is rarely used. The law does contain, however, provisions against restrictive arrangements. In this respect, an arrangement is restrictive whether it is expressed or implied, whether written, oral or by behaviour, whether or not legally binding.

Intellectual proprietary rights
Israel is a party to international agreements regarding proprietary and intellectual rights and has several laws regulating trademarks, copyrights, patents etc.
- The Trademarks Ordinance 1972 and its provisions set the rules governing trademarks in Israel. Usually, trademarks are granted for an initial period of 10 years and may be renewed for further periods
- Copyrights: the Israel Copyrights Act protects creative rights over literature, arts and music. Usually, protection is granted for the lifetime of the creator plus 50-70 years
- The Patent Act 1967 regulates the protection of patents in Israel. Regular patents are protected over 20 years from the date of application, while ‘patents of addition’ are protected for the unexpired term of the main patent. Patents may be granted on the invention of a product that is innovative, and which was never previously used or published

Banking and finance
The banking system in Israel provides services for all types of financial transactions: trade in securities, trusteeship, underwriting, provision of credit (including credit-card companies) and financial advisory services for pensions and retirement.

The Bank of Israel regulates the banks; its responsibilities include:
- Regulating and directing monetary policies
- Economic advice to the Government
- The foreign-currency market and managing the state’s foreign-exchange reserves
- Monitoring and analysing foreign-exchange activity
- Banking supervision
- Promoting financial stability
- Currency issues
- Banker of the government
- Representing Israel in international institutions
Exchange controls and money laundering

Israeli residents are free to engage in foreign-currency transactions and in transactions with foreign residents. Under the general permit, some reporting procedures are imposed on banks, financial brokers and institutional investors.

In addition, Israel has joined the fight against money laundering with the enactment of the Prohibition of Money Laundering Act. Under this Act, the Israel Money Laundering and Terror Financing Prohibition Authority imposes certain identification and reporting obligations on financial institutions and business-service providers. These institutions and businesses-service providers are required to identify anyone, either an individual or a company, requesting various services.

Foreign Account Tax Compliance Act

On 30 July 2014, the United states and Israel signed an intergovernmental agreement to improve international tax compliance and regarding FATCA (the US Foreign Account Tax Compliance Act). Under this agreement, the two governments are set to regulate the transfer of information to the government of the US by the Israeli tax authorities (ITA). This information will be gathered by financial institutions in Israel and will include details about accounts held in Israeli financial institutions by US citizens, US Green-Card bearers, US residents and other entities in which US nationals have a substantial interest.

The necessary legislation has been incorporated into the ITO and its regulations. The first year in respect of which this information was gathered and reported to the ITA (under IGA model 1) was fiscal year 2015.

Common Reporting Standard

In May 2016 the ITA signed a multilateral agreement for automatic exchange of financial information – the CRS; and a multilateral agreement for the application and reporting of multinational enterprises by way of annual submission of an overall report, comprehensive on the entire entities within a multinational group – the CbC (country-by-country) report.

In order to give effect to the new CRS agreement, the Finance Committee of the Knesset is currently in the process of making regulations which will incorporate them into the law. Once the legislative work is finished, reporting financial institutions will be expected to gather and forward to the ITA information on reportable accounts, i.e. the accounts of non-Israeli residents. Gathering of financial information with respect to reportable accounts, on the basis of common reporting and due diligence rules, may include: names and personal details of account holders; account numbers; account balances or values as at the end of the relevant calendar year, and; in the case of depository accounts, the total gross amount of interest paid or credited to the account.

Under this common standard, the government will automatically exchange with exchange partners, as appropriate, on an annual basis, financial information obtained from reporting financial institutions. The first information exchange under the CRS is set to relate to the financial year 2018.
Country-by-country reporting

CbC reporting, being the cornerstone of the OECD recommendations on the implementation of transfer pricing documentation as part of the BEPS initiative, was formulated in order to target tax shifting by multinational enterprises (MNEs), amid a world-wide growing phenomenon of transfer pricing manoeuvres.

The CbC report is one of a three-report set: 1) a master file, containing standardised information relevant for all MNE group members; 2) a local file, referring specifically to material transactions of the local taxpayer; and 3) the CbC report, which requires MNEs to detail financial and tax information regarding their worldwide organisational structure. The CbC report will provide national tax authorities with a panoramic-view of the MNE’s business model. It will detail information relating to the allocation of the MNE’s income and taxes paid (e.g. where are services/goods are manufactured, where they provided/sold), together with certain indicators about the location of economic activity within the group (where intellectual property is owned, where value is added, and where risk is taken). This will allow countries better to monitor MNEs operating in their jurisdiction and provide greater transparency.

However, despite the general filing requirement, the OECD has recommended that MNEs with annual consolidated group revenue in the immediately preceding fiscal year of less than EUR 750 million be exempted.

The first such information exchange relates to financial year 2016.

Know your customer

As part of the world-wide struggle against money laundering and terrorist financing and in accordance with international standards, an amendment to the Prohibition on Money Laundering Law was recently enacted. As a consequence, the Law now imposes an obligation of identification and the performance of ‘know-your-customer’ procedures by advocates and certified public accountants who provide their customers with ‘business services’. These include business transactions as specified in the Law, such as the buying or selling of real property, the establishment of companies, financial management and other such issues.

Accordingly, business-service providers are required, in addition to having good customer knowledge, to have internal guidelines and policies for evaluating risk management, to follow inspection bodies’ periodic publications, to train staff and have strict procedures for archiving information.

Incentives to investment

The State of Israel encourages investment from both Israeli and foreign residents, by offering a wide range of cash and tax incentives and benefits to enterprises that increase the productive capacity of the economy, improve the country’s balance of payments or diversify employment opportunities in the periphery. Special emphasis is given to high-tech companies and R&D activities, as considerable importance is attached to these fields.

Grants

Particular locations and business sectors within Israel qualify for special grants. Industrial enterprises located in Development Zone A (namely, Galilee, the Jordan valley, the Negev and Jerusalem) are entitled to a grant if their comprehensive investment plan meets specified criteria: mainly requiring export of at least 25% of their products or services. Approved enterprises are entitled to grants of up to 20% of investment made in tangible fixed assets.

For tax incentives, see Chapter 6.
R&D supportive fund
The Israeli Innovation Authority (formerly known as the ‘Chief Scientist’) supports innovative R&D projects through granting financial aid packages. Commercial companies in all sectors may receive grants to help them develop new products or new existing technologies; regardless of the stage of development the product/technology is in. Approved companies may receive grants of up to 50% of their approved R&D expenses (higher in specified development regions) in respect of employees, third-party contractors etc. These funds are very attractive to companies developing high production-risk technologies, as the fund provides both substantial monetary financing and takes some of the risk involved in the production - regardless of the future profit or success of the project. A supported enterprise will return the fund by way of royalties paid out of sold products, only if and when the project reaches commercial viability.

Grants
Under the Act, enterprises whose income and commercial performance are similar in kind to those of preferred enterprises are also eligible to receive investment-related government grants (subject to actual investment in fixed assets; in contrast to general R&D expenses required under the R&D supportive fund, as discussed above). However, such grants are pending approval of a detailed investment programme involving construction of an industrial plant. There is a preference for enterprises that will offer greater employment opportunities.

Grants provided by virtue of this programme may be given up to a limit of 20% of the expenses of the enterprise for those enterprises located in priority zone A or 30% to enterprises located in the Negev region.

In the past, less attractive benefits were offered, but these will be summarised below, as some enterprises may still be subject to them.

Previously, a CIT rate of 25% was offered for a general 10-year period for approved enterprises in priority zone A or for seven years outside this zone, commencing in the fiscal year in which the enterprise first has taxable income. However, as the standard CIT rate has been gradually reduced over the years and has dipped below the reduced rate, it has no actual effect nowadays. However, a withholding tax rate of 15% may apply when the approved enterprise distributes its income, either in that 10-year period or in the subsequent 12 years.

Foreign investor companies, controlling 25% or more of the enterprise's share capital or owning 25% or more of the enterprise's total loan capital (an investment of at least ILS 5 million), may be eligible for greater benefits. The greater the investment, the greater the tax reduction: 20%, 15% and 10% for investments representing 49%, 75% and 90% ownership.

Participation in salary costs
Additional grants are offered under the Employment Grant Programme. This programme offers a maximum of 25% grant to enterprises' salary costs, as incentive to employment in Israel's periphery. This grant is affected by the enterprise's location, number of employees and their salaries

Miscellaneous
Several additional articles of legislation accommodate other incentives for investors:
• Capital Investments in the Tourist Industry Encouragement Order.
• Rental Housing Building Incentives Law deals with tax rates and VAT benefits.
• Overseas marketing encouragement funds – The Ministry of Economy and Industry offers an array of changing temporary tools for companies promoting overseas marketing.

Eilat free trade zone
Eilat, being the southernmost city in Israel, is granted a special tax treatment. Eilat businesses enjoy a nil VAT rate (save for private cars, tobacco and alcohol) and employer grants to cover up to 20% of salary costs.
4. The accounting and audit environment

Accounting regulations

Under the Companies Act 1999, all companies, including privately owned companies, must file audited 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.

As of 2008, 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 in accordance with International Financial Reporting Standards (IFRS). Under the Israeli Securities Regulations (Annual Financial Statements) 2010, public companies must provide additional disclosures in their annual and quarterly financial statements.

Non publicly traded entities may file their financial statements in either IFRS or Israeli GAAP.

Due to adoption of the International Accounting Standards Board's (IASB) framework in Israel, Israeli GAAP is based on this Framework's concepts, with the following underlying assumptions: the accruals basis of accounting and going concern. Additional important concepts, adopted in Israeli GAAP through the said Framework, are qualitative characteristics of financial statements, such as comprehensibility, materiality, relevance, reliability and comparability.

Today, Israeli GAAP includes a full set of IFRS for public companies, and a set of accounting standards previously issued by the Israel Accounting Standards Board as mentioned above, which were adopted on a standard-by-standard basis by the IASB for the private sector.

Audit requirements

Audit in Israel is a mandatory requirement by law. Excepted from this rule are private companies with an annual turnover of no more than ILS 621,597, which may choose not to appoint an Auditor. The purpose of this legislation is to control companies’ financial reports. Auditors in Israel are supervised by the Israeli Auditors Council (IAC) and by the Institute of Certified Public Accountants in Israel (ICPA). Only licensed accountants may certify audit reports.

The conduct of an audit in Israel is based on generally accepted auditing standards, namely those prescribed by the Auditors Regulations (Auditors Mode of Performance) 1973. The Israeli Institute of Certified Public Accountants is a member of the International Federation of Accountants (IFAC). The auditing guidelines published by the ICPA are based on international auditing standards. Auditor’s reports must include the auditor’s opinion as to the fair presentation of the affairs of the company. In general, an opinion must be given by an Israeli certified public accountant.

Under these regulations auditors are required to prepare and perform the audit to obtain reasonable assurance as for the recorded financial statements, accounting principles used and significant estimates made by the board of directors and managers. Auditors are also required to make sure that these matters are presented fairly with respect to all material aspects of the company's financial performance.

The Israeli Accountancy Council is a corresponding office in charge of auditing in Israel. It is a statutory body overseen by the Ministry of Justice. Its role is divided between drafting the licence exams, issuing accountancy licences and supervising auditing trainees. It has disciplinary powers to punish those failing to meet its technical standards, and may fine and/or revoke licences.
Israeli Prospectus and European Legislation
In May 2017, the Israel Securities Authority signed two memoranda of understanding (MOUs) on collaboration with European financial-market regulators. The first MOU, signed with the United Kingdom’s FCA, establishes principles for cooperation, consultation, and exchange of information regarding FCA approval for prospectuses filed by Israeli issuers. According to the agreement, Israeli prospectuses, after including a series of additional details, may be filed in the United Kingdom. The second MOU, signed with the German BaFin (Bundesanstalt für Finanzdienstleistungsaufsicht) sets down principles for cooperation, consultation, and exchange of information concerning filing Israeli-issued prospectuses in Germany and filing German-issued prospectuses in Israel.

The signing of these two MOUs follows the decision in July 2015 of the European Securities and Markets Authority (ESMA) to recognise Israeli regulation covering the contents and format of prospectuses under the Securities Law. The decision followed an assessment performed by ESMA and the ISA, in response to an amendment to the European Directive and changes in Israeli regulation. The significance of the decision is that Israeli prospectuses, with the addition of certain additional information, may be filed in EU Member States for the purpose of listing an Israeli company in an EU exchange, according to specific collaboration agreements in place with European regulators.

Signing the MOUs with the British and German authorities is part of the programme to implement the ESMA decision by signing agreements with individual EU regulators on mutual recognition of prospectuses.
5. Overview of the tax system

Main taxes
The principal taxes in Israel are
• Income and capital gains tax, governed by the Income Tax Ordinance (hereinafter: ‘ITO’)
• Value added tax
• Land appreciation tax

Tax authorities
The Israeli Tax Authority (ITA) is in charge of the collection of direct and indirect taxes, including VAT and real-property taxes. The ITA has several regional and national units: assessing offices, VAT offices, real-property taxation offices, customs houses, collection enforcement and income tax investigations.

Israel operates a two-tier taxation system under which corporate taxation is imposed at the level of the company and again when the income is distributed to shareholders. The amount of tax payable is self-assessed, and reviewed by the tax authorities. It is possible to appeal against a tax assessment to the ITA.

All Israeli residents – individuals and entities - are liable to pay tax on their entire worldwide income. Foreign residents are also liable to tax on income generated or derived in Israel, subject to source rules and applicable double taxation treaties.
6. Taxes on business

Corporate income tax

Scope and extent

Corporate income tax is imposed on the worldwide income of Israeli-resident companies. An Israeli branch of a non-resident company is taxed as though it were a regular resident company, with respect to all its profits derived in Israel.

The tax year in Israel is the calendar year: from 1 January to 31 December. Specific companies may opt for a different tax year under special circumstances, subject to ITA approval, mainly: quoted companies, subsidiaries the majority of whose shares are held by a foreign entity or taxpayers related to another company that has opted for a different tax year.

Partnerships are transparent vehicles for tax purposes. Each partner is assessed to tax on his share of the partnership's profit or loss. Consequently, an actual distribution of the partnership's profits to the partners is not considered as a taxable event. A company's share in a partnership's taxable profits is taxed at the regular corporate tax rate.

Company residence

A company is deemed to be resident in Israel if it was incorporated in Israel or is controlled and managed from Israel. The Israeli tax authorities attach extra sensitivity to this topic and recent court rulings have given broad and purposive interpretations to the term ‘management and control’. This topic should be addressed on a case-by-case basis.

Taxable income and accounting basis

Companies are subject to corporate income tax. Corporate tax applies, according to the personal tax régime, to all income irrespective of where the income arises. In order to avoid international double taxation, the ITO contains a unilateral tax-credit mechanism. Israel's network of international double taxation treaties acts for the same purpose.

Taxable income is calculated based on annual financial reports, using Israeli GAAP, with necessary adjustments. Adjustments for inflation or currency appreciation are treated as ordinary income or expenditure. Adopted IFRS standards have to be adjusted to the Israeli GAAP for the adjusted tax calculation.

In general, companies' tax reporting must be made on the accruals basis. Accounting on a cash basis is available under certain conditions. The choice between the two methods depends mainly on the nature of the company's trade and on possession of substantial business inventory. Companies not holding inventory (e.g. service providers, consulting companies, the liberal professions practised corporately) are allowed to opt for the cash basis rather than the accruals basis.

There is no special treatment for inventories.
Deductions

The rule is that only expenses involved in generating income are deductible for tax purposes. Current expenses incurred in the line of income production are also deductible (e.g. interest and royalties). This rule embodies great significance due to the fact that Israeli law does not prescribe an equity-to-debt ratio. Consequently, shareholders may opt to finance a significant proportion of a company's activity through participant debt.

According to the ITO regulations, an individual holding a substantial share of the company's capital and who is in receipt of interest payments on account of a participant loan will be exempt from tax as long as the interest payments are, at most, at a rate equivalent to the Consumer Price Index or to the relevant currency-exchange index. Concurrently, the interest expenses may be deductible in the hands of the paying company.

On the other hand, interest and indexation payments made due to late tax payment to the ITO are not deductible. Neither capital expenditure nor private expenses nor dividends are deductible.

Some expenses are fully or partially non-deductible (e.g. provisions for vacation or for severance, entertainment, travel expenses etc). These expenses ought to be adjusted when being included in the tax return. These expenses are divided into many different criteria; a partial list follows in Table 2.

<table>
<thead>
<tr>
<th>Expense</th>
<th>Deduction</th>
</tr>
</thead>
<tbody>
<tr>
<td>Provision for holidays or severance</td>
<td>Not deductible at all unless actual cash flow involved.</td>
</tr>
<tr>
<td>Entertaining</td>
<td></td>
</tr>
<tr>
<td>Light refreshments</td>
<td>80% deductible.</td>
</tr>
<tr>
<td>Meals &amp; employee functions</td>
<td>Non-deductible.</td>
</tr>
<tr>
<td>Meals and accommodation for foreign visitors</td>
<td>Deductible under certain conditions.</td>
</tr>
<tr>
<td>Travelling expenses</td>
<td></td>
</tr>
<tr>
<td>Business travel abroad</td>
<td>Deductible up to specified maxima.</td>
</tr>
<tr>
<td>Motor expenses</td>
<td>Deductible under certain conditions; specifically, assessment of employees in respect of car benefit-in-kind.</td>
</tr>
<tr>
<td>Benefits-in-kind</td>
<td></td>
</tr>
<tr>
<td>General</td>
<td>Non-deductible, unless their value is added to the employee's taxable income</td>
</tr>
</tbody>
</table>

The ITO addresses certain non-deductible expenses as ‘excess expenses’. When these expenses are borne by a company, it is taxed by way of monthly advanced payments. These advanced payments may be offset against the regular corporate tax payments but are not refundable. This means that when there are not enough taxable profits to be offset, the remainder of the advanced payments may be carried forward, under certain conditions, to future tax years.

Tax depreciation

Only those assets listed in the Income Tax Regulations, and utilised in the line of income production, may be depreciated for tax purposes. The Regulations also prescribe the rates to be used; depreciation is exclusively by the straight-line method. Table 3 shows the prescribed rates for the principal classes of fixed assets.
Table 3

<table>
<thead>
<tr>
<th>Asset class</th>
<th>Depreciation rate (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Buildings</td>
<td>1.5 – 6.5</td>
</tr>
<tr>
<td>Electronic equipment</td>
<td>15 - 33</td>
</tr>
<tr>
<td>Factories</td>
<td>10</td>
</tr>
<tr>
<td>Vehicles</td>
<td>15 – 25</td>
</tr>
<tr>
<td>Machinery</td>
<td>3 - 20</td>
</tr>
<tr>
<td>Agricultural assets</td>
<td>6 – 20</td>
</tr>
<tr>
<td>Goodwill</td>
<td>10</td>
</tr>
<tr>
<td>Intangible properties</td>
<td>According to asset’s * economical life span* (*)</td>
</tr>
<tr>
<td>Air plains</td>
<td>30</td>
</tr>
<tr>
<td>Marine Vessels</td>
<td>20</td>
</tr>
</tbody>
</table>

(*) Frequently subjected to ITA's careful testing.

No depreciation on land is allowed.

**Accelerated depreciation**

The ITA may prescribe accelerated depreciation rates for equipment items exposed to premature wear due to multiple shift operations.

**Capital gains**

Resident companies are taxable on worldwide capital gains. Capital gains are divided into real and inflationary components. The real element of a capital gain is taxable as income at the standard rate of corporate income tax; the inflationary element is exempt from tax if accrued after 1 January 1994 and taxed at a rate of 10% if accrued previously.

Capital losses may be used to offset capital gains derived in the same or future tax years indefinitely and without time or value limitation. However, no loss carry-back is allowed. In each year, capital losses are first to be offset against real gains and then against inflationary amounts. One portion of real capital loss may be offset against one portion of real capital gain (1:1 ratio), whereas one portion of real capital loss may be offset against 3.5 portions of inflationary gains (1:3.5 ratio).

Capital losses from assets located abroad (i.e. originating abroad) must be first offset against foreign capital gains. The remaining losses, if any, may be then offset against capital gains generated in Israel.

Gains derived from sales of Israeli real property or from sales of an interest in a real-property association (an entity whose primary assets relate to Israeli real property) are subject to land appreciation tax. Land appreciation tax rates are, however, similar to those applicable to other capital gains.

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

- Any asset located in Israel
- Any asset located outside Israel, but which is in substance connected directly or indirectly to an asset, inventory or a legal right in a real-property association in Israel.
- Any share in a foreign company having substantial interest in a property located in Israel

Tax is imposed in both last cases on the portion of income which relates to such property in Israel.
Exemption for foreign residents
Foreign residents who are not engaged in business in Israel may qualify for exemption from capital gains tax on disposals of securities traded on the Tel-Aviv Stock Exchange or on other recognised foreign stock exchanges. Foreign residents should also qualify for an exemption from capital gains tax on disposals of all types of Israeli securities purchased after 31 December 2008, provided that the seller did not purchase the securities from a related party. In addition, the exemption will not apply if most of the assets in the company whose securities were sold consist of Israeli real property.

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

Retained profits
It is generally accepted that share value is affected by the volume of the company’s undistributed (retained) profits. Therefore, special rules apply to a disposal of a company’s shares whose sale value is so affected by retained profits. The rule dictates that that part of the share value that is affected by the company’s retained profits will be taxed as if these profits were distributed as dividends immediately prior to the date of disposal. Where a part of share value accrued before 1 January 2003, that gain will be taxed at 10%.

Dividends, interests and royalties
In light of the two-tier corporate tax system, resident companies are exempt from corporate tax on dividends paid out of regular income that was accrued or derived from sources within Israel. Companies are generally subject to the normal corporate tax rate on foreign dividend income that is paid from a foreign source or from income accrued or derived abroad. A participation exemption may apply in the case of certain holding companies (see below).

Interest received, whether on deposits with banks and other credit institutions or from loans, is generally taxable as income in the hands of the company as are royalties.

Losses
Losses incurred in the line of a trade or business may be offset against income from any source in the same tax year. Losses may be carried forward indefinitely, to be offset against income from trade or business, including against capital gains obtained from disposing of an asset that was used in the line of a trade or a business activity. Losses may not be carried back.

Group taxation
The filing of a consolidated tax return is generally not permitted in Israel. Each company in a group is required to file its own return. However, under certain conditions, industrial companies may file a consolidated return according to the Industry Encouragement (Taxes) Law.

Withholding taxes
Most taxable income in Israel is subject to withholding taxes, unless an applicable tax treaty instructs otherwise. The ITA may approve of a request for partial or total exemption from withholding tax.

Generally, a 25% withholding tax is levied on dividends paid to a non-controlling foreign resident (i.e. a person holding less than 10% of the Israeli paying company’s shares). Otherwise, the rate is 30%. These rates may be reduced under a tax treaty and under the participation-exemption framework (see below).
Interest payments to a non-resident individual for debentures issued by an Israeli company and traded on the Israeli stock exchange are exempt from withholding tax in Israel unless 1) the gains are attributable to the non-resident’s permanent establishment in Israel; 2) the foreign bondholder is a ‘significant shareholder’ in the Israeli company; or 3) is considered to be related to or to have a special relationship with the bond-issuing Israeli company. Other interest payments are subject to withholding tax of 15%. The rate increases to 25% if the payments are index-linked. In special circumstances, interest paid to non-resident individuals may be subjected to the marginal tax rates (up to 48%). These rates may be reduced under a tax treaty.

Interest payments made to foreign companies are subject to withholding tax at a rate of 25% subject to tax treaties. There are a number of exemptions for different types of interest.

Unless effected by a tax treaty, royalty payments may be subjected to a withholding tax of up to 48%, according to the ITO regulations. Should such a payment ‘escape’ the regulations net, it will be subject to a withholding tax at the corporate tax rate or to a 25% tax rate if paid to an individual.

**Thin capitalisation**

There are no tax measures against thin capitalisation in Israel.

**Transfer pricing**

Israel’s transfer-pricing rules are based on the OECD guidelines and apply to transactions between an Israeli-resident entity and a related non-resident entity. The rules prescribe a hierarchy of transfer-pricing methods; in general, transaction-based methods are preferred over profit-based methods.

If requested to do so by the ITA, a company must provide a detailed transfer-pricing study to justify the prices it charges to and the prices that are charged by related foreign entities. Regardless of any transfer-pricing investigation, companies must always attach a statement to their annual tax return confirming that their cross-border transactions with related parties were carried out in arm’s length terms.

**Controlled foreign company (CFC) rules**

CFC rules may apply where Israeli shareholders own more than 50% of a foreign company’s ‘means of control’ or where Israeli shareholders hold the right to prevent the adoption of substantial managerial decisions in a foreign company that has accumulated undistributed passive profits that have suffered tax at an overall rate lower than 15%.

In such a case, the Israeli controlling member(s) will be treated as if they had received their proportionate share of the foreign company’s retained profits as dividend income (deemed dividends), even though the profits were not actually distributed. The deemed dividend will be taxed in the hands of the Israeli resident at a rate of 25% for a non-material shareholder and at 30% for a material shareholder.

No foreign tax credit is allowed against such a deemed distribution. Foreign tax credit will, however, be allowed only in the fiscal year in which the CFC actually makes a distribution. In that year, the foreign tax may be credited against any income source (including employment salary, for example) and may even be refunded if no other income is available for set-off.

**Other significant anti-avoidance rules**

There is a general anti-abuse rule, under which the ITA may disregard a transaction deemed to be carried out artificially, meaning, that one of its principal objectives was improper avoidance or improper reduction of the tax burden.

Moreover, taxpayers are required to declare, together with their annual tax return, special transactions listed and defined as aggressive tax planning.
Tax rate
The rate of corporate income tax in 2017 is 24%. It is set to be reduced to 23% with effect from 1 January 2018. Table 4 below shows the CIT rate over the last few years.

<table>
<thead>
<tr>
<th>CIT rate</th>
<th>2015</th>
<th>2016</th>
<th>2017</th>
<th>2018</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>26.5%</td>
<td>25%</td>
<td>24%</td>
<td>23%</td>
</tr>
</tbody>
</table>

International holding company régime (participation exemption)
In order to encourage foreign investment in Israel, participation exemptions from tax on dividend income are granted to Israeli holding companies satisfying the following criteria:

- The company is a private company incorporated in and managed from Israel
- The company must be holding foreign subsidiaries, located in a contracting state sharing a double tax treaty with Israel or in a foreign country which imposes a minimum 15% tax on business income
- The company is primarily a holding company with no business income other than income from services provided to its subsidiaries
- Investments in its investee companies comprise at least 75% of the company's total assets and have a value at least ILS 50 million

The investee companies must, for this purpose, have at least 75% of their total income qualified as business income under Israeli law, originating from outside Israel and have at least 80% of their total assets originating non-Israeli assets.

These holding companies will also be exempt from tax on capital gains derived from disposals of shares in qualifying investee companies and from tax on financial income derived from investments in companies quoted on the Israel Stock Exchange

A reduced withholding tax of 5% also applies to dividends paid by the holding company to its non-resident shareholders.

Tax incentives
Preferred enterprises
Under the Capital Investment Encouragement Act 1959, (last amended on 29 December 2016), enterprises are eligible for tax benefits under the Tax Benefits Programme.

Enterprises whose income is (broadly) generated in the course of industrial activity from any of the activities listed here may be qualified as a preferred enterprise:

- Sale of goods manufactured in that enterprise
- Income from granting rights to use in, or income from royalties from the use of, its know-how or software, developed in that enterprise or
- Income from R&D services provided to a foreign resident (approval is required for this last section)

It is further required that such an enterprise meet one of the following commercial targets:

- It is involved in the nano-tech or bio-tech industry (subject to approval)
- No more than 75% of its income in a given fiscal year from sale of its produce is generated in one territory or
- 25% or more of its income in a given fiscal year from sale of its produce is generated in one territory whose population consists of 14 million people or more
Enterprises meeting these criteria are eligible for reduced tax rates. Preferred enterprises in priority zone A will be subject to CIT at 7.5%, whilst preferred enterprises outside that zone will be subject to CIT at 16%. Withholding tax on dividends to the enterprise’s shareholders will be 20%.

Preferred enterprises with substantially large income (ILS 1000 million or more) and forming part of a corporate group whose inclusive income is ILS 10 000 million or more) – Special Preferred Enterprises – will enjoy further reduced CIT rates. Enterprises in priority zone A will be subject to CIT at 5%, whilst preferred enterprises outside that zone will be subject to CIT at 8%. These CIT rates are limited to 10 years, after which time they will increase to the 7.5/16% cap. Withholding tax on dividends to domestic shareholders will be 20% but 5% on dividends to foreign shareholders (valid until 31 December 2019).

In the frame of the last amendment to the Act, great emphasis was given to technological R&D enterprises. Enterprises meeting further requirements, such as minimum R&D expense levels, a minimum number of employees engaged in R&D and a minimum venture-capital raising threshold, may be eligible for even greater reduced CIT rates of 12% for enterprises outside priority zone A and only 4% withholding tax on dividends paid to foreign controlling companies with more than 90% control.

**Tax Compliance**

**Simplified taxation**
Companies may not use a simplified form of tax bookkeeping administration such as single-entry bookkeeping. In some cases, companies may report on a cash basis rather than on an accruals basis (see above).

In some cases, diamond dealers may pay income tax based on a percentage of their turnover.

**Assessment procedure**
Tax payable is self-assessed and may be reviewed by the tax authorities.

**Returns and payments**
Companies must generally file their annual tax return within five months of their year-end, although extensions may be allowed in certain circumstances. Penalties apply if tax returns are filed late. Any taxes due are payable upon submission of the report and are linked to the Consumer Price Index and bear interest at an additional 4% from the end of the year for which the report relates to until paid in full.

However, since most companies must make instalment payments in advance, which are deductible against the final tax, the indexation and interest do not usually affect the entire tax in full. These are either payable monthly at a fixed percentage of turnover, or each month for 10 months beginning with the second month of the tax year at a fixed percentage of the previous tax year’s taxable income.

**Appeals**
Corporate income tax is self-assessed. However, the ITA is given four years, counting from the end of the tax year in which the return was filled, to examine and if necessary reject the self-assessed return and issue a determination (assessment) of the company’s taxable income, to the best of its judgment. The taxpayer may appeal against this determination to the ITA, in the first instance. Should the appeal be denied or should an agreement not be reached, the taxpayer may appeal further to the regional court and thence to the Supreme Court of Israel.
Value added tax

Taxable entities
The Israeli value added tax is similar in concept and design to the VAT in force in the European Union. Any person carrying out transactions of a commercial nature is in principle liable to charge VAT, even in the case of one-off commercial transactions. Imported goods are also subject to VAT, in the hands of the importer.

Financial institutions and non-profit organisations do not charge VAT. Instead, they are liable to a tax on payroll and profits at a rate of 17% (the standard VAT rate) for financial institutions or 7.5% for non-profit organisations.

Taxable activities- standard, reduced and zero rates
VAT applies to the sale of most goods and services. As of October 2015, the standard rate is 17%. No differential VAT rate is available as in some European countries on targeted types of goods (as books or mobility aids for the elderly for example). However, a nil rate applies on specific listed transactions, mainly to exports of goods (including intangible goods sold to non-residents), provision of tourism services, export/import-related transactions, services to international organisations, and the sale of fresh fruit and vegetables).

Exempt supplies
Certain supplies are exempt from VAT. These include residential leases, the sale of goods in respect of which the input VAT was not deductible, and supplies by financial institutions (see above).

Vendors with an annual turnover below ILS 99,006 (referred to as ‘exempt vendors’), with the exception of the liberal professions, are not allowed to issue tax invoices and their transactions are exempt.

Registration
Any person practising a trade or business activity in Israel must register with the VAT authorities. Whether one operates a trade or a business is a question to be addressed on a case-by-case basis.

Returns and payments
The standard return period is the calendar month, and VAT returns are due by the 15th of the following month. Businesses with an annual turnover of less than ILS 910,000 may opt for a two-month return period. Where the VAT charged by the business on sales (output tax) exceeds the VAT suffered by it on purchases (input tax), the balance is payable to the ITA. On the contrary, where input tax exceeds output tax, the balance is repaid by the ITA.

As of 2012, VAT returns must be filed electronically.

Transactions with traders in the PLO
Since 1994 Israel and the Palestine Authority (hereinafter: ‘PA’) form a quasi-customs union. It contains elements of a free-trade area where commodities are traded free of customs duty and (effectively) free of VAT.

Accordingly, transactions of registered traders of both sides are not taken to be imports or exports and registered traders in both territories may thus deduct their output VAT in their place of registration. For an example, a PA-registered trader, purchasing goods from an Israeli-registered trader, may claim his input tax, paid in Israel, against his output VAT in the PA, and vice versa.

Therefore, output tax levied in one territory and eventually claimed by registered traders in the other territory, will be distributed, in accordance with the destination principle, through a clearance mechanism.
7. Personal taxation

Income tax

Residence

Israeli residents are subject to individual income tax and capital gains tax on a worldwide basis. Non-residents are taxed on income generated in Israel.

An individual is considered a resident of Israel for tax purposes if his or her ‘centre of vital interests’ is in Israel. Residence can also be determined by physical presence in Israel. An individual will be deemed to be resident for tax purposes if one of two tests is met:

• He or she spends 183 days or more in Israel in any given tax year or
• He or she spends 30 or more days in Israel in the current tax year, and if the aggregated period of the stay in Israel in that tax year and in the two preceding tax years cumulatively amounts to 425 days or more.

Structure of income tax

Taxable income includes

• Income from employment (including severance pay)
• Income from a business (self-employment)
• Income from investments (dividends, interest, royalties)
• Rental income
• Pension income

Income from employment and self-employment is regarded as income derived from personal exertion, to distinguish it from passive (investment) income.

The family unit

Married couples are generally assessed jointly. When reporting income for a married couple, the default position is to attribute all income to the spouse with the higher personal-exertion earnings – the ‘registered spouse’. This could cause higher taxation as the lower tax brackets are not available to the unregistered spouse. It is possible to request a separate computation under certain conditions for the annual income of the unregistered spouse.

For example, a couple may request that each spouse be taxed separately, if there is no dependence between the income sources of the spouses (e.g. where one spouse is employed in a company/business owned by the other spouse). In some cases, the couple may request to elect which of them is to be considered as the registered spouse.

Israeli tax law defines ‘spouse’ as a person who is married to the taxpayer and manages a joint household together with him or her. Therefore, single-sex couples who are legally married are considered a family unit for tax purposes in Israel.

Even under separate computation, if the family unit has passive income, it will be attributed to the spouse with the higher ‘personal exertion’ taxable income. If there is no income of personal exertion, or if they are equal, the passive income will be attributed to the registered spouse. If the passive income is generated by an asset possessed by one of the spouses at least one year before they were married or the asset was inherited, the taxpayer who owns it may request for the attribution of that income to him.

Taxation of employment income

In general, taxable employment income covers salary and virtually all cash and 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 when establishing the employee’s taxable income.

The most common benefits-in-kind are company cars and mobile phones.
The taxation of company cars depends on whether the car was registered before, on or after 1 January 2010. For cars registered in 2010 and subsequently, 2.48% of the car’s list price when new is added each year to the employee’s taxable income, subject to a ceiling list price of ILS 500 030. Some restrictions apply.

In respect of cars registered before 1 January 2010, a fixed amount is added to the employee’s gross salary. These amounts depend on which of seven categories the car falls into, and varies from ILS 2580 to ILS 10 410.

The taxable benefit-in-kind for a mobile phone is the lower of 50% of the monthly charges (including fixed costs) and NIS 105. Any contribution made by the employee to the charges may be deducted.

**Salary withholding tax**

Although employees’ tax liability is calculated on an annual basis, monthly taxes are deducted at source by the employer. Withholding is based on the employee’s residual tax bracket, taking into account certain personal allowances, such as child allowance.

**Taxation of personal business income**

The rules for computing income from independent personal services are similar to those applicable to a company. Personal business income includes a partner’s share of partnership income. Withdrawals of income from a personal business are not subject to salary tax.

**Dividends**

A 30% withholding tax (final rate) is generally imposed on dividends paid to individual shareholders holding 10% or more of the shares in an Israeli company (i.e. material shareholders) and a 25% withholding tax (final rate) imposed on non-material individual. In the absence of an applicable tax treaty, payments to a foreign non-resident individual are treated identically.

**Interest**

Interest on deposits, fully linked to the Consumer Price Index or to the foreign currency’s exchange rate, are free of tax with regard to the indexation element. The real component is, however, taxed at a final rate of 25% (or 20% if the income was derived before 31 December 2011, subject to certain complex conditions).

Interest on deposits unlinked or not fully linked is subject to final withholding tax at 15%.

**Royalties**

Royalties paid to Israeli residents are subject to the passive income tax brackets, ranging from 30% to 48% (unless the recipient of the royalties is older than 60). See under ‘Tax rates’ below.

In the absence of a corresponding double tax treaty, a 25% tax is withheld from royalties paid to a foreign non-resident individual and a tax equal to the corporate tax out of royalties paid to a foreign non-resident company.

**Rental income**

Individuals in receipt of rental income may opt to be taxed in one of three ways:

- **Total exemption**, if the rent does not exceed ILS 5010 per month (aggregated amount of all let property)
- A **flat rate of 10%** (without a tax ceiling or exemption) on rental income that does not constitute business or trade income. Under this option, there is no deduction of depreciation, and no eligibility for credit, deductions or exemptions
- **Taxation at the normal progressive rates**. Here, the individual may deduct depreciation losses and also be eligible for any credit, deductions or exemptions
Capital gains
The same division of capital gains between inflationary and real gains applies for individuals as for companies. Inflationary gains accrued before 1 January 1994 are taxed at 10% whereas inflationary gains accrued thereafter are exempt.

Taxation of ‘real’ gains is divided on a linear basis between three different periods:
• Gains attributable to the period prior to 31.12.2002 are subject to the passive income tax brackets
• Gains attributable to the period between 1.1.2003 and 31.12.2011 are taxed at a rate of 20%, and
• Gains attributable to the period from 1.1.2012 onwards are taxable at 25%

A gain from the sale of a material shareholding in a company is subject to a 30% tax.

For capital gains arising from land, see Chapter 8.

Allowances and deductions
Individuals may deduct contributions to a self-funded approved provident or pension fund.

A number of tax credits are awarded according to the family status of the taxpayer. Some examples follow in Table 5.

Table 5

<table>
<thead>
<tr>
<th>Type of credit</th>
<th>Recipient</th>
<th>Tax points awarded</th>
<th>2017 value (ILS)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Child’s natal and adulthood credit</td>
<td>Mother (in year of birth and year of 18th birthday)</td>
<td>1.5</td>
<td>3870</td>
</tr>
<tr>
<td>Child (1 to 5 years old)(^1)</td>
<td>Mother</td>
<td>2.5</td>
<td>6450</td>
</tr>
<tr>
<td>Child (6 to 17 years old)(^1)</td>
<td>Mother</td>
<td>1</td>
<td>2580</td>
</tr>
<tr>
<td>Child’s natal credit</td>
<td>Father (in year of birth)</td>
<td>1.5</td>
<td>3870</td>
</tr>
<tr>
<td>Child (1 to 5 years old)(^1)</td>
<td>Father</td>
<td>2.5</td>
<td>6450</td>
</tr>
<tr>
<td>Israeli citizen’s credit</td>
<td>Qualifying taxpayer</td>
<td>2.25</td>
<td>5832</td>
</tr>
<tr>
<td>Female tax credit</td>
<td>Female taxpayers</td>
<td>0.5</td>
<td>1296</td>
</tr>
<tr>
<td>Disabled child’s credit</td>
<td>Qualifying child</td>
<td>2</td>
<td>5184</td>
</tr>
</tbody>
</table>

\(^1\) Payable up to and including the year in which the upper age is reached

Additional tax credits are awarded in respect of academic degrees and child-support payments and to new citizens, discharged soldiers etc.

Tax rates
Individuals’ income is taxed gradually according to progressive tax rates.

Two scales of progressive rates apply: one for personal-exertion income and one for passive income. Tables 6 and 7 describe those rates.
Table 6  Personal-exertion income rates for 2017

<table>
<thead>
<tr>
<th>Taxable income (NIS)</th>
<th>Rate (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>First 74 640</td>
<td>10</td>
</tr>
<tr>
<td>Next 32 399</td>
<td>14</td>
</tr>
<tr>
<td>Next 64 799</td>
<td>20</td>
</tr>
<tr>
<td>Next 66 959</td>
<td>31</td>
</tr>
<tr>
<td>Next 258 119</td>
<td>35</td>
</tr>
<tr>
<td>Balance over 496 920</td>
<td>47</td>
</tr>
</tbody>
</table>

Table 7  Passive-income rates for 2017

<table>
<thead>
<tr>
<th>Taxable income (NIS)</th>
<th>Rate (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>First 238 800</td>
<td>31</td>
</tr>
<tr>
<td>Next 258 120</td>
<td>35</td>
</tr>
<tr>
<td>Balance over 496 920</td>
<td>47</td>
</tr>
</tbody>
</table>

The passive income scale does not apply to taxpayers aged 60 and over.

Starting in 2013, a 3% surcharge is imposed on the upper band of taxable income over NIS 640 000 (leading to an effective top tax rate of 50%).

**Exit tax**

Any person ceasing to be resident in Israel is subject to an ‘exit tax’, under which the individual is deemed to have disposed of all of his or her assets for their market value, and is liable to tax on any deemed resulting capital gain at the applicable capital gains rates. Payment of this tax may be made upon deemed disposal or be postponed until the asset is actually sold (pending an election by the taxpayer).

**Immigrants (Olim) and returners**

Immigrants and Israeli citizens returning from long-term residence abroad may be entitled under the Aliyah programme to exemptions from income tax and capital gains tax and reporting for the first 10 years of their stay in Israel on certain types of income generated abroad and assets located abroad.

**The Angels Law – amortisation of acquisition amounts**

The so-called Angels Law allows individual investors (or partnerships of individual investors), investing in private Israeli companies, to deduct up to ILS 5 million worth of investment against their overall taxable income from all sources. The investment must be made in a qualifying target company and only in consideration for the issue of original shares. The investment amount may be amortised over three years and the maximum investment per company is ILS 5 million.

Upon sale of the investor’s original issued shares, the amount of investments amortised will affect the cost basis. In order to calculate the capital gain, the amount amortised will be subtracted from the original cost (the investment) causing the proceeds from the sale to be higher (for tax purposes). However, the general capital gains tax rate ranges between 25% to 30%, whilst marginal income tax rates are a maximum 47% (plus excess 3%).
Returns and payments
Employees whose remuneration is subject to tax as employment income do not generally have to file a tax return unless their earnings exceed ILS 641 000.

For self-employed taxpayers, the tax authorities determine advance tax payments according to monthly turnover. Most taxpayers make 12 monthly advance payments at a fixed percentage of turnover.

At the end of the tax year, individuals are generally required to file an annual personal tax return, unless the main source of income is employment income, which is withheld by the employer at source. The tax return must be submitted by 30 April of the year following the tax year, with any tax due, paid at the same time.

A non-resident individual who has taxable income during a tax year is required to file an annual personal tax return.

Appeals
The procedure is the same as for companies.

Inheritance and gift taxes
Israel does not levy inheritance tax nor is there a gift tax on assets held for personal reasons.

Wealth tax
Israel does not levy a wealth tax.
7a. Trust taxation

General
Trusts in Israel are recognised by the Israeli Tax Ordinance (ITO) as legitimate vehicles to hold assets for the benefit of different beneficiaries. There is a general definition of a ‘trust’ in the ITO, which captures trust-based arrangements, whether they are made in or outside Israel, and whether they are called trusts or otherwise. As to foreign trust entities, there are specific entities that are recognised by the ITO as trusts, including foundations (under the laws of the Netherlands, Panama, Bahamas and Liechtenstein) and establishments (Anstalten) and Registered Trusts (under the laws of Liechtenstein).

Israel recognises the common law concept of trusts. The concept of private trust under the Trust Law 1979 is widely known and used by professionals in Israel. In practice, however, its main application is in the frame of nominee agreements and trust relationships, which the Israeli Tax Authorities (ITA) excluded in a circular published in late 2016 from the Trust Chapter of the Tax Ordinance (ITO).

Taxation – basics
A tax reform with regard to trusts was enacted in Israel on 1 January 2006, whereby a Trust Chapter was added to the ITO, preparing the way for the taxation of trusts, foundations and other similar legal structures. The taxation of the trust’s income, gains, and sometimes even principal estate is, mainly, affected by three factors:

• The residence of the settlor
• The residence of the beneficiaries and
• The revocability/irrevocability of the trust

The ITO contains detailed rules to determine when and if a trust can be treated as irrevocable. The title of the trust, as such, is not a factor in this respect; most of the factors that do affect irrevocability involve:

• The question of control in the trust or the power to alter the ownership of the trust’s principal estate/income
• The degree to which the settlor or the beneficiaries may intervene or influence the trustees’ decisions and
• The power to change or alter the composition of the beneficiaries (e.g. a settlor having the option to become a beneficiary)

The place of residence of the trustees has no influence over the method under which the trust will be taxed.

The trust’s income is by default attributed to the trustee(s) and taxed in the hands of the trustee(s). However, the trustee serves only as a reporting and tax-paying agent. There is, though, a possibility in some cases to opt to have the settlor or the beneficiary as the reporting and tax-paying agent. This choice is conditional and irreversible and thus should be picked carefully. Such election will allow the beneficiary or the settlor (as the case may be) to use his personal credits and losses against the income of the trustee.

On the tax compliance side, the trustee should register and open a file for the trust with the ITA; on the tax treatment side, many limitations are imposed on the trustee. For example, the trustee may not use the settlor’s credits or losses and vice versa; the settlor may not use the trustee’s losses or deduct his expenses.

Starting from the tax year 2016, reporting obligations have been also imposed on Israeli beneficiaries. Persons who are 25 years old and above, listed as beneficiaries in a trust whose value is at least NIS 500,000 will be subject under certain conditions to reporting obligations.

Classes of trust
In light of the three factors (as discussed above) the ITO categorises all trusts into trust classes. Under the 2006 original legislation the ITO defined 4 classes of trust:

• An Israeli-Resident Trust - in principle an Israeli-Resident Trust reflects, for tax purposes, the status of an Israeli resident (i.e. the trust is subject to tax in Israel on any income derived by the trustee from sources in Israel and outside Israel)
• A Foreign-Resident Settlor Trust – a Foreign-Resident Settlor Trust is a trust of which the settlor was or is a non-Israeli resident on the day
the trust was established or in the relevant fiscal year. In principle a Foreign-Resident Settlor Trust reflects for tax purposes in Israel the status of a foreign resident (i.e. the trust is subject to tax in Israel on income derived by the trustee from sources within Israel only). Israeli beneficiaries in this trust class could escape taxation on foreign income (perpetually, in theory).

- A Foreign-Resident Beneficiary Trust – under certain conditions this also reflects for tax purposes in Israel the status of a foreign resident
- A Will Trust

In August 2013, the Trust Chapter underwent a thorough legislative modification, effective from 1 January 2014. The main amendment altered the former classification of trusts, with the aim of subjecting most trusts with Israeli beneficiaries to Israeli tax.

The main change targeted the tax liabilities and reporting obligations of a Foreign-Resident Settlor Trust; applicable to those trusts which had in their records sometime in the past at least one Israeli beneficiary or those the settlor of which had died. Such a Foreign-Resident Settlor Trust's classification has been altered to an Israeli-Resident Trust.

A Foreign-Resident Settlor Trust will continue to be treated as such only in cases where all of its beneficiaries are not and have not ever been Israeli residents, unless the Israeli beneficiary is a Public Institution Beneficiary. These are now classified as a Foreign-Resident Trust. In principle a Foreign-Resident Trust reflects, for tax purposes, the status of a foreign resident (i.e. the trust is subject to tax in Israel on income derived by the trustee from sources within Israel only).

If a Foreign-Resident Settlor Trust has been established by foreign settlors but there is at present at least one individual Israeli beneficiary, such a trust has become taxable in Israel and is classified in one of two optional ways: as an Israeli Beneficiary Trust or a Relatives Trust, depending on the family relations between the settlor and the Israeli beneficiaries.

An Israeli Beneficiary Trust is in general very similar to an Israeli-Resident Trust.

A Relatives Trust is a trust of which the settlor is, from its inception and until the fiscal year in question, a foreign resident and all of the Israeli beneficiaries are relatives of the foreign settlor. The trustee in such a Relatives Trust may have, under some conditions, the right to choose one of two alternatives to tax the trust’s income generated after 1 January 2014 and outside Israel only

- Distribution Track – with 30% tax (plus excise tax (3%) on earnings above ILS 640 000) upon distributions made to Israeli-resident beneficiaries, whether a distribution of income or principal, in money or in money’s worth (unless the trustee proves such distribution was made out of principal estate that would not have suffered any tax if that principal had been distributed to the beneficiary directly from the settlor) or
- Designated Track - in which the trust’s annual income is taxed at 25% (plus excise tax (3%) on earnings above ILS 640 000)

Each track results in substantially different tax outcomes and the election is irreversible.

International aspects
As we have seen, the default position is to tax the trust’s income in the hands of the trustee. This is true even when a trust makes distributions to the beneficiaries. This stands in contrast to the tax treatment that some other jurisdictions apply to income distributions (as an income on a remittance basis); e.g. the US shifts the taxation of distributed income – trust income that is distributed to the beneficiaries is taxed in their hands, and not in the hands of the trustee. In Israel, though, the trustee will remain the tax agent regardless of any distributions and regardless of any tax paid by the beneficiaries.

From an international taxation point of view, this might lead to inadvertent double taxation. This occurs when, on the one hand, each country appoints different tax agents and, on the other hand, disallows foreign tax credits that were borne by a different taxpayer. This double taxation may be resolved in most cases by a query to the ITA or by proper advance tax planning.
8. Other taxes

**Registration and stamp duties**
Israel has no stamp duty on signed documents.

**Property and property transfer taxes**
Israel does not levy any property or property transfer taxes.

**Real-property purchase tax**
A purchaser of real property or shares in a property association (an entity all of whose assets consist of immovable property) must pay purchase tax usually at 6% of the asset's purchase price. No purchase tax is levied on the purchase of a residential property of a value up to ILS 1,600,175 and constituting the taxpayer's sole private residence. A progressive tax scale applies for residential property worth above that amount.

**Land appreciation tax**
Capital gains derived from the disposal of land or shares in a property association are taxable under the Land Taxation Act, at rates ranging between 20% and 50%, depending on the identity of the disposer and the period of ownership.

**Customs & excise duties**
Customs duties are levied on imported goods. Excise taxes apply to fuel, tobacco products and alcohol.
9. Social security contributions

Employee and employer contributions
Both employers and employees pay social security contributions in Israel. The employee’s share includes compulsory health insurance. National insurance rates are based on gross monthly income and are shown in Table 8.

Table 8

<table>
<thead>
<tr>
<th>Monthly salary (ILS)</th>
<th>Employee</th>
<th>Employer</th>
</tr>
</thead>
<tbody>
<tr>
<td>0-5678</td>
<td>3.50%</td>
<td>3.45%</td>
</tr>
<tr>
<td>5678-43 240</td>
<td>12.00%</td>
<td>7.5%</td>
</tr>
</tbody>
</table>

No further contributions are payable by either the employer or the employee on that part of earnings exceeding ILS 43 240 per month.

Self-employed contributions
Self-employed persons who are 18 years of age and over who have not yet reached retirement age pay their contributions as follows:
- A 6.72% national insurance contribution and 3.1% health insurance contribution for that share of their income which equals up to 60% of the average wage (ILS 5678 as of 01.01.2016)
- 11.23% national insurance contributions and 5% health insurance contributions for that share of their income exceeding 60% of the average wage, up to ILS 43 240.
10. Moore Stephens in Israel

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International liaison: Amnon Argaman, amnon@lionorl.co.il

There is also an office in Jerusalem.
Appendix 1: Double tax treaties

Double tax treaties
Israel has comprehensive double taxation treaties with the following countries:

<table>
<thead>
<tr>
<th>Country</th>
<th>Country</th>
<th>Country</th>
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</thead>
<tbody>
<tr>
<td>Austria</td>
<td>India</td>
<td>Portugal</td>
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<tr>
<td>Belarus</td>
<td>Ireland</td>
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<td>Italy</td>
<td>Russia</td>
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<td>Jamaica</td>
<td>Singapore</td>
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<td>Bulgaria</td>
<td>Japan</td>
<td>Slovakia</td>
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<tr>
<td>Canada</td>
<td>Korea (South)</td>
<td>Slovenia</td>
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<td>Latvia</td>
<td>South Africa</td>
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<tr>
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<td>Ethiopia</td>
<td>Mexico</td>
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<td>Moldova</td>
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<td>United States</td>
</tr>
<tr>
<td>Greece</td>
<td>Philippines</td>
<td>Uzbekistan</td>
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<tr>
<td>Hungary</td>
<td>Poland</td>
<td>Vietnam</td>
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</tbody>
</table>

A comprehensive treaty has also been signed with Azerbaijan, but this is yet to enter into force.

Double taxation treaties: estates, gifts and inheritances
Israel has no such treaties.

Social security agreements
Israel has a network of social security agreements that coordinate the Israeli National Insurance scheme with the comparable schemes of other countries. These agreements are intended to ensure the rights of Israeli citizens who are located in other countries with which Israel has signed a social security treaty. These treaties ensure payment of government stipends, prevent dual social security taxation, maintain continuity of insurance coverage, etc.

Most of Israel’s social security treaties include provisions in the following areas: retirement, disability, and survivor benefits. Some cover child and maternal benefits, as well. The countries with which Israel has social security agreements are:

<table>
<thead>
<tr>
<th>Country</th>
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<tbody>
<tr>
<td>Austria</td>
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</table>

1 These agreements have limited scope.
Moore Stephens member firms may be found in 104 countries and territories around the world, with correspondent firms in another eight.

<table>
<thead>
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*denotes a correspondent firm only  
For more details, see [www.moorestephens.com](http://www.moorestephens.com) under ‘Locations’.