

VAT NAVIGATOR

International Information for International Business



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Israel



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Dr. Shekel founded Shekel & Co. in 1992. He lectures at forums and conferences organized by the Israel Bar Association and the Institute of Certified Public Accountants. He is a member of the Tax Committee of the Israel Bar Association. Dr. Shekel has published dozens of articles in professional periodicals and newspapers and his book was published by Routledge-Cavendish Ltd in the U.S., U.K. and Canada, under the title "The Timing of Income Recognition in Tax Law and the Time Value of Money."

Dr. Shekel received his LL.B. from Tel Aviv University in 1985 and Ph.D. from Brunel University, U.K. in 2007.

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Between 1997 and 2011, Moti Eilon acted as the General Director of the Israeli Customs & VAT department, Ministry of Finance, and was a board member of the Israeli Accountants Council. Moti is an expert in indirect taxation and he was a lecturer in the management faculty of Tel Aviv University and in the accounting faculty of the Tel Aviv College of Management. After retirement from the Ministry of Finance, Moti joined the tax department of Deloitte Israel for 8 years and since 2008 works with Shekel & Co.

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Israel

Dr. Moshe Shekel, *Founder, Shekel & Co.* and Moti Eilon, *Shekel & Co.*

1. Introduction

1.1. Summary of VAT rates

In Israel, the following VAT rates apply:

- Standard rate: 18 percent
- No reduced rates
- Other: Zero rate and exemptions

1.2. Legal basis

VAT is imposed in Israel according to the Value Added Tax Law, 5736-1975 (the "VAT Law"). The Israeli Minister of Finance is responsible for the implementation of the VAT Law and is authorised to institute regulations on matters related to its implementation. In accordance with that authority, the Minister instituted two sets of regulations: the Value Added Tax Regulations, 5736-1976 (the "General Regulations"); and the Value Added Tax Regulations (Registration), 5736-1976 (the "Registration Regulations"). Administrative oversight of Israeli VAT is carried out by the Israeli Tax Authority under the authority of its Director.

1.3. Recent developments

There have been no significant legal developments regarding VAT or purchase tax between July 1, 2013 and July 1, 2014.

2. Scope

2.1. In general

VAT is imposed in Israel on different types of taxpayers (i.e. dealers, nonprofit organisations, financial institutions) in two different ways:

VAT, as a multistage tax, is imposed on transactions made in Israel by dealers in the course of their business. A "transaction" is defined in the VAT Law as "the sale of an asset or the performance of a service". VAT is also imposed on occasional transactions and on the importation of goods into Israel; and

Profit tax and wage tax are imposed on financial institutions, both at the same rate as the standard VAT

rate of 18 percent; and, wage tax, at a reduced rate of 7.5 percent, is imposed on nonprofit organisations.

2.2. Territorial application

Israel for VAT purposes includes its territorial seas. Additionally, although the VAT Law generally does not apply to the areas controlled by the Palestinian Authority, it applies to the following: (i) to transactions performed by an Israeli resident in Palestinian areas; and (ii) to activities performed in Palestinian areas by an Israeli resident. Furthermore, subsequent to the Paris Agreement, the transactions made between Israeli dealers and Palestinian dealers are not deemed as export or import transactions.

2.3. Taxable transactions – overview

Under Israeli VAT law, a "transaction" is defined as a sale of an asset or the performance of a service, by a "dealer," during the course of its business.

A sale of an asset includes, among other things, letting, hire-purchase, grant of a right to utilise in exchange for consideration, grant of a right therein, utilisation for personal needs, the expropriation or forfeiture or confiscation in exchange for consideration, the bestowal as a gift, and a real estate association act, as defined in the Israeli Land Taxation Law.

An asset includes goods or real estate, while "goods" includes, among other things, intangible assets such as rights, know-how and so on, excluding a right in real estate or in securities or negotiable documents and rights therein, and "real estate" includes real estate rights and real estate association rights as defined in the Israeli Land Taxation Law.

A service is defined as the performance of an action for another in exchange for consideration, other than a sale, including a credit transaction and a deposit of money. However, if the performance of an action is carried out by a body of persons, it is regarded as a "service" even if no consideration is due.

An "occasional transaction" is also taxable, if such a transaction consists of the occasional sale of goods or performance of a service, the sale or service being of a

commercial character. Additionally, with regard to an “occasional transaction” that is the sale of real estate, there is no requirement that the sale is of commercial character, and special rules exist according to which an occasional transaction may be taxable depending on the identity of the seller and the purchaser, and the type of real estate (residential dwelling or other).

2.4. Excluded transactions

As a result of the definition of the term “goods” for Israeli VAT purposes, the sale of securities or negotiable document or right therein is not regarded as a taxable transaction. However, any gains that arise from those sales might be taxable.

For further details on excluded transactions, see Section 13.3.

3. Taxable persons

3.1. Definition/scope

Under Israeli VAT law, a “dealer” is a person, individual or entity, other than a nonprofit organisation or financial institution that sells any asset or renders any service (in Israel) during the course of its business. A “dealer” is also a person that effects an occasional transaction, and the declaration regarding the transaction is regarded as fulfillment of registration liability.

A nonprofit organisation or financial institution must also register for VAT purposes. The following are regarded as nonprofit organisations: the state of Israel and local (municipal) authorities; a body of persons, incorporated or not, which does not carry out a business for profit; a body corporate established by virtue of law which is not a corporation, partnership, or cooperative; and a benefit fund exempt from income tax. The following are regarded as financial organisations: a financial bank, an insurance company and others designated by the Minister of Finance.

Mandatory registration

All dealers must register with the Tax Authority. There is no threshold requirement. Dealers are liable to register with the Tax Authority no later than the day of its first transaction.

An exempt dealer – a dealer with turnover that does not exceed NIS77,993 – is required to register. Note that persons exempt from registration in Section 3.3 are not regarded as an “exempt dealer”.

3.2. Voluntary registration

A person establishing a new business in Israel may request early registration for VAT purposes, and the Director is required to register such a person if he is satisfied with the fact that a new business is in the process of being established.

If an entity is registered as a dealer, financial institution or nonprofit organisation, it is possible to request that the Director exercises his authority to change such registration to another category, as relevant.

3.3. Exemptions from registration

The following two categories of persons are exempt from registration for Israeli VAT purposes:

(i) A person who carries out transactions which are all exempt from VAT according to exemption of: (a) the letting of apartments for residential purposes, for less than 25 years; and (b) the sale of apartments, having been let for residential purposes, for not less than 5 years, if the building was approved as a rental building under the Encouragement of Capital Investments Law; and

(ii) A person who performs specific services, defined in Regulation 6a of the General Regulations, according to which the VAT liability is shifted to the recipient (i.e. the reverse charge mechanism).

3.4. Group and divisional registration

In general, under Israeli VAT law, an entity that carries out several businesses, or consists of several units within one business, is required to register as one dealer in respect of all of them. However, it may register separately in respect of each business or unit pending the fulfillment of the following two conditions: (i) separate accounting records are kept for each of them; and (ii) the separate registration will not result in the dealer being treated as an “exempt dealer”. An “exempt dealer” is a dealer whose turnover does not exceed the sum of NIS77,993 per year.

On the other hand, two or more registered dealers may ask for a joint registration pending the fulfillment of the following two conditions: (i) the account books of all the registered dealers are kept jointly (this requirement is not necessary in cases where the registered dealers requesting joint registration are a parent company and its subsidiary); and (ii) one of the dealers is appointed as a representative.

The Director has the authority to split the registration of registered entity and to register part of its activities in one category and the other part in another category. For example, for VAT purposes, the Director can choose to register part of the activities as a dealer and the other part as a financial institution or as a nonprofit organisation. This authority is pending the Director’s conclusion that the reclassifications of certain activities are essentially closer to the other category of activities.

3.5. Registration of non-resident persons

A person, who is a “foreign resident” and carries out business activities in Israel, and is therefore liable to VAT in Israel, must, within 30 days from the beginning of the business or activity, appoint a representative whose permanent place of residence is in Israel, and must submit to the Tax Authority the representative’s written consent. According to the viewpoint of the Tax Authority, this obligation also applies to a foreign company if one or more of its directors is an Israeli resident. Notwithstanding this obligation, and additional forms that must be signed, the registration requirements applicable to non-resident persons are identical to the requirements for resident persons.

4. Taxable transactions

4.1. Goods

Under Israeli VAT law, the supply of all types of goods, both tangible and intangible, is a taxable transaction in Israel whether the goods are supplied within

Israel or shipped for export from Israel. “Zero-rated” goods are considered to be subject to VAT, but subject to tax at a rate of zero.

However, as mentioned in Section 2.4, securities or negotiable documents or rights therein are not regarded as “goods” and therefore the supply of such items is not regarded as a sale transaction. Although those items are not regarded as “goods” their sale is regarded as a “service” and taxable accordingly (see Section 13.3).

The distinction between goods and services is important because the rules governing the place of supply for goods are distinct, and can operate significantly differently, from the rules of governing the place of supply for services. Place of supply rules, in turn, determine whether a transaction is taxable in Israel, as discussed in Section 5.

Tax point

Generally, the tax point on the supply of goods is when goods are delivered to the purchaser. The time of payment is the tax point; however, if the goods are cooling or heating systems, prefabricated buildings, acoustic ceilings, traffic lights or elevators, and if an amount is paid on account of the consideration before the supply was made, the tax point of the advanced amount is at the time of payment.

4.2. Services

The provision of a service within Israel by a dealer during the course of its business is a taxable transaction. But, as mentioned in Section 2.2, a service is deemed to have been rendered in Israel if the service was rendered to an Israeli entity; or, the service was rendered in relation to assets located in Israel.

According to the Tax Authority’s viewpoint, each service provided to an Israeli entity by a foreign entity is taxable in Israel, and the reverse charge mechanism should be applicable. This viewpoint may be challenged, as there is a long-term debate in Israel on whether or not “imported services” are taxable in Israel. The argument that “imported services” are not taxable in Israel is based on Section 2 of the VAT Law, which imposes VAT on transactions carried out in Israel and on the importation of goods into Israel, without relating to the importation of services.

The distinction between goods and services is important because the rules governing the place of supply for goods are distinct and can operate significantly differently from the rules governing the place of supply for services. Place of supply rules, in turn, determine whether a transaction is taxable in Israel, as discussed in Section 5.

Tax point

For taxpayers on a cash basis the tax point is at the time a payment is received. Taxpayers on a cash basis are with their annual turnover that does not exceed NIS15 million, including transactions of the extension of credit (i.e. loans). For all other service providers the tax point is when the service is performed.

4.3. Intangibles

The Israeli VAT Law defines the term “goods” broadly, including “rights, interests and other intan-

gible asset and, inter alia, know-how.” Therefore the supply of intangible property is subject to VAT. Furthermore, as a result of this definition even the import of intangibles is taxable. However, the rights in real estate and in corporate entities are excluded from the term “intangibles”.

Note that the licensing of intangibles is not treated as a supply of goods; only the transfer of rights in intangibles are treated as a supply.

4.4. Immovable property

The sale of immovable property located in Israel by a dealer within the course of its business is subject to VAT. Nevertheless, there are some exemptions: (i) the letting of apartments for residential purposes, for less than 25 years, is exempt from VAT; (ii) the sale of apartments, having been let for residential purposes, for not less than 5 years, is exempt if the building was approved as a rental building under the Encouragement of Capital Investments Law; (iii) the possession of real estate against key-money; and (iv) any transaction regarding real estate located in the Eilat Free Trade Zone.

It is essential to take into consideration that the term “land” (or “real estate”) is defined in the Israeli VAT Law in a very broad manner, including: real estate rights and real estate association rights such as membership in the association, the right to the assets of the association upon liquidation, the right to the profits of the association and other rights as defined in the Israeli Land Taxation Law.

4.5. Other taxable transactions

For Israeli VAT purposes, all transactions are characterised as either supplies of goods or as supplies of services and there are no other categories of taxable transactions.

4.6. Mixed transactions

In general, because a single VAT rate applies in Israel, the tax rate applicable to mixed transactions is not problematic. However, in the case where part of a transaction consists of the sale of an asset and part of the same transaction consists of the provision of a service (e.g. the sale of furniture with the service of shipping and assembly), the date of accrual of the tax liability may be different. In such a case, the accepted practice is to apply a legal rule according to which “the incidental follows the essence,” i.e. the date of accrual of tax liability will be according to the date applicable to the sale of the furniture.

4.7. Taxation of imports

4.7.1. In general

In general under Israeli VAT law, imports of goods, including intangibles, are taxable. While the VAT levied on imported goods is payable at the time of importation and collected by the customs officials, the VAT levied on imported intangibles is payable via the periodic returns the dealer submits (similar to the “reverse charge” mechanism) or, if the importer is not a “registered dealer”, they must submit a form and payment relating to the occasional transaction. The Tax Authority views the imports of services as liable for VAT and the procedures applicable for the payment of

VAT in such cases are identical to those applicable to imported intangibles.

4.7.2. Imports of goods

When goods are imported into Israel from abroad the importer is liable for all import duties, including VAT. In general, VAT is imposed on all goods entering Israel, except for very few and special exemptions. The importer, whether a taxpayer or not, is required to send electronically, prior to the release of the goods from Customs, an entry document, which is a declaration regarding the imported goods. The entry document can only be sent after paying all applicable import duties.

The sales from the areas under the control of the Palestinian Authority into Israel, and vice versa, are not considered exports and/or imports.

4.7.3. Temporary imports or re-exported goods

The Israeli VAT General Regulations allow for a partial VAT liability to apply to goods imported into Israel temporarily for limited periods of up to 4.5 years. In cases where the period the goods will remain in Israel is up to six months, 10 percent of the full VAT will be payable and an additional 10 percent will be added for each additional six months, i.e. when the period is up to 1 year the VAT will be 20 percent of the full amount, and when the period is up to 1.5 years the VAT will be 30 percent of the full amount etc. For a period of 4.5 years, the payable VAT will reach 90 percent of the VAT liability. For the purpose of temporary importation, a special tariff code, "No. 207", was added to the Israeli tariff, and the classification according to this code is conditional on the provision of a security for the full amount of import duty and VAT, until the conditions for relief are met.

4.7.4. Imports of services

The Israeli Tax Authority's position is that the import of services is liable to tax. This is based on the legislation according to which a service provided to an Israeli entity is deemed to have been rendered in Israel and from a specific regulation according to which the liability to pay tax rests on the recipient of the service. Although other views exist, based on the fact that the VAT Law states that tax is imposed on transactions carried out in Israel and on the import of goods, without relating to the import of services, the issue has not been raised before Israel's Supreme Court.

If a service is provided wholly or partially within Israel by a foreigner, the provider must inquire as to whether or not it is required to register with the Tax Authority. If the answer is positive, then the service would no longer be classified as an import. On the other hand, if the answer is negative then the situation is identical to the situation in which the entire service is provided outside of Israel.

In case the non-resident service provider is not liable for registering in Israel the accepted practice is as follows: if the recipient is a "dealer," it is required to apply the reverse charge mechanism, and the standard rules governing the recovery of input tax would apply; if the recipient is not a "dealer", it is required

to report and pay the tax in the same manner as for occasional transactions.

5. Place of supply (or equivalent)

5.1. Place of supply – goods

The Israeli VAT Law and regulations do not determine the place of supply, but rather determines the place of the transaction.

- *Tangible goods*: An asset is deemed to have been sold in Israel if the asset is delivered in Israel or if it is exported from Israel; and
- *Intangible goods*: Intangibles are deemed to have been sold in Israel if the seller is an Israeli resident.

5.2. Place of supply – services

Place of supply rules are important for the VAT analysis because, in general, transactions are not subject to Israeli VAT unless Israel is the place of transaction.

A service is deemed to have been rendered in Israel if one of the following applies: (i) the service is rendered by a person whose business is in Israel, including an agent or a branch performing business in Israel; (ii) the service is rendered to an Israeli entity; or (iii) the service is rendered in relation to assets located in Israel.

5.3. Place of supply – other transactions

The Israeli VAT system classifies transactions as supplies of either goods or services, and does not use other classifications. There are, therefore, no place of supply rules applicable to transactions other than supplies of goods or services.

5.4. Place of supply – imports

Imported goods are treated as supplied outside Israel. However, the importer will generally need to account for VAT in respect of the imported goods prior to the release of the goods from Customs. As the VAT imposed on imports is not regarded as VAT imposed on transactions, the Israeli VAT Law does not actually determine the place of supply for imports. However, the legislation does determine in Section 26 that the time of payment is at the time the goods leave Customs.

5.5. Special situations

An activity carried out by a financial institution or nonprofit organisation is deemed to be conducted in Israel if one of the following applies: (i) the activity is wholly or mostly conducted in Israel; (ii) the activity is conducted by a person whose principal activity is in Israel; or (iii) part of an activity is conducted in Israel, while most of the activity is conducted abroad.

6. Chargeable amount

6.1. Valuation – generally

Generally, the price of a transaction for Israeli VAT purposes is the consideration agreed upon between the parties. This price is required to include the following items: any tax, levy, fee or other compulsory payment imposed on the transaction other than un-

der the VAT Law. Additionally, the price must include expenditures incurred in carrying out the transaction which the recipient is required to refund; interest that the recipient is required to pay; and compensation for any violation of the agreement that does not entail cancellation of the transaction.

Under certain circumstances, the price of the transaction would not be the agreed consideration, but rather will be defined as the market value of the transaction or, if the market value cannot be determined, the price would be the cost of the asset or service plus profit customary in such transactions. These circumstances include: (i) in case the price is affected by a special relationship between the seller and buyer; (ii) in case no price has been set by the date of the accrual of the tax liability; or (iii) in case the consideration is not wholly monetary.

6.2. Adjustments to stated sales price

Under the Israeli VAT principal rule, the price of a transaction is the consideration agreed upon, if following the issuance of the invoice the parties decide to make a change relating to the consideration, the adjustment can be carried out by issuing a credit tax invoice or a supplementary tax invoice – depending on the nature of the change.

According to an Israeli Supreme Court decision, in a situation where the sale terms include a provision for payment in instalments (or a late payment), the “linkage differentials” are not part of the price for VAT purposes.

However, as a result of an audit, the Tax Authority may challenge the stated price and issue an assessment to the best of its judgment. The notification of the assessment must specify the arguments for challenging the stated price. For more information regarding assessments see Section 10.6.

6.3. Valuation of imports

The value for Israeli VAT purposes of imported goods is the same as the import value for customs purposes plus any customs duty and other tax or levy that applies to the import (except the VAT itself). However, if the imported good are intangibles, on which the Customs Ordinance does not apply, the price of the consideration, in Israeli New Shekel (NIS), is used to purchase the foreign currency when acquired for payment of the consideration and if no foreign currency was acquired then the normal valuation method applies.

In circumstances under which the customs officials disagree on the stated price, any change to the stated price made by the officials triggers the change of the price for VAT purposes. All VAT deduction rules (such as input tax) apply to the changed price (to the additional assessed VAT).

6.4. Co-ordination of VAT, customs, and income tax pricing

In Israel, the customs value, determined in accordance with customs legislation is the starting point for calculating the taxable amount of an import for VAT purposes, subject to certain adjustments.

6.5. Non-functional currency transactions

In Israel, when any sum relevant to the value of a supply is expressed in a currency other than Israeli New Shekel (NIS), that sum must be converted into NIS at the known official exchange rate published by the Israel Central Bank on the date of the accrual of tax liability.

7. Tax rates

7.1. Standard rate

The standard rate of Israeli VAT is 18 percent.

7.2. Reduced and supplementary rates

There are no reduced or supplementary rates of VAT in Israel.

7.3. Exempt supplies or equivalent

The Israeli VAT Law exempts a number of transactions from VAT liability, including the following:

- Rental transactions for residential purposes;
- Transferring possession of real estate in exchange for key-money;
- Transactions made by an exempt dealer, whose annual turnover does not exceed NIS77,993;
- The sale of an asset, in circumstances according to which input tax in respect of its acquisition or importation could not be deducted lawfully at the time of its acquisition or importation; and
- Loans provided by dealers to financial institutions.

In addition, the sale and the import of unset diamonds and unset precious and semiprecious stones, including any transaction relating to those assets, is exempt from VAT.

For the full list of exempt supplies, see the link provided in Appendix 15.1.

7.4. Zero-rated supplies or equivalent

In general, for Israeli VAT purposes zero-rated transactions are those that are regarded as export transactions. Additionally, in certain cases transactions may be zero-rated even if they are not export transactions.

The following are zero-rated transactions:

- Export of goods;
- Export of intangibles;
- Export of services;
- Services connected to the entry into Israel or departure from Israel of aircraft or sea vessels;
- Rendering services abroad by a dealer whose principal place of business is in Israel;
- Overnight accommodations provided to a foreign tourist in hotels, including services provided by the hotel incidentally to the overnight stay;
- Renting of a private motor vehicle to a foreign tourist;
- Transportation of a foreign tourist for sightseeing;
- Some services provided by a travel agent to a foreign tourist;
- The sale to a foreign tourist of the right to participate in an international conference held in Israel;
- Aircraft transportation services provided to a foreign tourist within Israel;

- The sale of a right to travel via international flights and sea vessels;
- The sale of fruit and vegetables;
- The sale of assets from a dealer to a company, in exchange for shares in the company alone, on condition that immediately following the sale, the seller will hold at least 90 percent of the shares of this company; and
- The sale of assets from a company to all shareholders in the course of liquidation, if certain conditions are met.

For the full list of zero-rated supplies, see the link provided in Appendix 15.1.

7.5. Imports

7.5.1. Reliefs from import VAT

Generally under Israeli VAT law, there are no reliefs or exemptions on imports, except for the following:

- The return of exported goods if the goods were not repaired, renovated, or improved while abroad;
- Imported gifts that are fully exempt from customs duties and have a value which does not exceed USD75;
- Imported original works of art, which are imported for the use by a museum, educational institution or a local authority; and
- Diamonds and stones.

7.5.2. Bonded warehouses, free zones, etc.

When goods are imported into Israel from abroad, the importer is allowed to store the goods in warehouses, which are under customs supervision, and the liability for import VAT is deferred until the goods are released from those warehouses.

In addition, the Seaport Free Zones Law permits the declaration of free zones in the vicinity of any seaport. According to that law, there is currently one free zone that is located in Eilat. The import of goods into the free zone is exempt from indirect taxes, including from VAT, until products are removed from this zone and transferred to other parts of the country. This free zone, which is located in the extreme southern part of Israel, is not large and very few projects are active in this free zone.

7.6. Exemptions for exports

Under Israeli law, all exports of goods and services are subject to a zero-rating.

8. Deduction and recovery of input tax

8.1. Input tax eligible for a deduction/credit

Israeli VAT is imposed on the transaction according to the value of the goods/service supplied. But, a dealer meeting certain criteria is allowed to deduct from its VAT liability "input VAT", which is the output VAT imposed on its inputs (purchases or imports) for the use in its business.

In order to qualify for a deduction of input tax the following criteria must be met:

- Only a registered dealer is allowed to deduct input tax;
- The input VAT can be deducted only if the input VAT is included in a tax invoice or in an import

entry document or in another document approved by the Director of the Tax Authority;

- The deduction applies to inputs that were purchased or imported for business purposes;
- The deduction is permitted only if the input is for use in a transaction liable to VAT. In this context, note that this condition does not prevent the deduction of overhead if all, or most of the business's transactions are liable to VAT; and
- The deduction can be executed provided that there is not any specific regulation preventing the deduction. Some specific regulations prohibit the deduction of input tax, as follows: tax imposed on the sale of a private vehicle (unless the dealer is specified in the regulation as a dealer allowed to deduct); tax imposed on hospitality, except if the hospitality is provided to a visitor from abroad; inputs in respect to employees.

8.2. Deduction rules for mixed transactions

Under Israeli VAT law, if a dealer purchases inputs to be used in its taxable and non-taxable transactions, there is a special regime for determining the amount of input tax that can be deducted. While input tax that is directly attributable to non-taxable transactions cannot be deducted and input tax that is directly attributable to taxable transactions can be fully deducted, input tax attributable to both, taxable and non-taxable transactions can be partly deducted.

In the case of mixed transactions the deductible proportion would be as follows:

- If the exact proportion that relates to the taxable transactions can be determined, the deduction would be the same proportion. For example: if a business bought five units of a product, three for the use in taxable transactions and two for the use in non-taxable transactions, the allowable deduction would be 60 percent;
- If the exact proportion cannot be determined the deduction would be as follows: if most of the use is attributable to taxable transactions, two-thirds of the input tax would be deductible; and if the most of the use is attributable to non-taxable transactions 1/4 of the input tax would be deductible; or
- Alternatively, there is an option to request that the director of the regional VAT office determines a different deductible proportion, based on actual evidence. Such a request is generally made in cases in which the use of the two fixed proportions is inequitable. For example: if a vehicle is used both by a business and for private matters, and it is possible to prove that 90 percent of the total use is for the business – in such a case the director may determine that instead of the deductible portion being two-thirds of the inputs, the 90 percent will apply.

8.3. Timing of the deduction or credit

Under Israeli VAT law, the input tax credit should generally be claimed in the first return submitted in the month after the purchase was made, and not later than six months from the purchase date. If for any reason the deduction was not made within six months of the purchase date, the director of the regional VAT

office may, upon request, extend the period for utilising the deduction for up to five years.

8.4. Deductions for input tax on capital goods or assets

The Israeli input tax deduction does not distinguish between input tax relating to capital items and other input tax. There is no special regime for input tax relating to capital items.

8.5. Refunds to registered persons

8.5.1. Resident taxable persons

VAT Refunds – Resident Taxable Persons

Under Israeli VAT law, refunds, in the sense of recovery of greater input VAT paid than output VAT liability incurred for a period, are handled under the normal VAT return. However, there are two return forms – one is relevant in cases where the dealer is liable to pay VAT and the other in cases where the dealer requests a refund.

If a taxpayer has an excess of input VAT in a return period, the Tax Authority will issue a refund to the taxpayer within 30 days. The director has the authority to delay the refund for a review of the return or for other suspicions of fraud.

If an error regarding input VAT is discovered, the correction should be made, or may be made, in one of the following ways: if the nature of the correction is an increase in the amount of input tax, the error must be corrected on the current period's VAT return, and if the nature of the correction is a decrease in the amount of input tax, the error must be corrected by submitting a supplementary return correcting the return from the original period in which the error occurred. According to the first option, no "linkage differentials and interest" will be added, while the second option triggers the addition of "linkage differentials and interest" to the VAT liability.

8.5.2. Customs union members or other special arrangements

VAT Refunds – Customs union member or other special arrangements

According to the Paris Protocol (the protocol of economic relations), which is an agreement between Israel and the Palestine Liberation Organisation (PLO) representing the Palestinian People, the two parties established a customs union for import and export matters and a special regime for VAT on transactions carried out between dealers of both parties to the agreement.

According to the special VAT regime, any dealer who sells or provides services to a dealer (or to a non-profit organisation or to a financial institution) that is registered for VAT according to the other party has to issue a particular tax invoice. The issuer and the recipient of such invoices both have to inform their relevant tax authority of such transactions, and to attach a copy of the invoices to the relevant form. This data is immediately computerised and is used in making a monthly VAT clearance between the authorities of both sides. This clearance procedure enables each authority to reimburse the input VAT to its dealers, while in parallel being reimbursed by the tax authority of the other side.

8.5.3. Foreign taxable persons

VAT Refunds – Foreign Taxable Persons

The Israeli VAT Law does not distinguish between resident and non-resident registered dealers. Therefore, non-Israeli established businesses that are registered for Israeli VAT are subject to the rules for domestic refunds.

8.6. Refunds to non-registered persons (domestic and foreign)

The Israeli VAT Law does not allow the refund of Israeli VAT to non-registered dealers, except for VAT paid by tourists while purchasing goods that they take with them when they leave Israel.

9. Extension or shifting of VAT liability

9.1. "Reverse charge" and similar provisions

Generally, the liability to account for VAT applies to the seller or the service provider. However, the Israeli VAT legislation includes a regulation according to which if a transaction is performed in Israel and the seller or the service provider is a foreign resident, the liability to account for VAT is shifted to the purchaser or the recipient. Liability for VAT will be applicable only if the sale or the provision of the service, by a foreigner, meets the conditions of a "transaction" for VAT purposes. If such a transaction is carried out and the recipient is a VAT-registered dealer, it will be required to account for VAT under the reverse charge mechanism. Meaning, the VAT registered dealer is deemed to have made a taxable supply of the imported transaction to itself, giving rise to an output tax liability and, if the input tax is deductible according to the deduction rules, to an equal input tax credit. In such a case, it bears no cost (not even a cash flow cost) as these two amounts are immediately self-cancelling.

However, if such a transaction occurs and the recipient is not a VAT registered dealer, whether it is a financial institution, a non-profit organization, or neither, it must account for VAT in the same manner that is required in the case of reporting occasional transactions.

9.2. Other mechanics applicable to supplies by non-residents (e.g. VAT representatives or agencies, subrogation, etc.)

Any foreigner who conducts business in Israel is required, as a condition of registering for VAT purposes, to appoint a representative whose permanent place of residence is in Israel. From the day the representative is appointed until the day he ceases the representation and notifies the VAT authorities of ceasing the representation, all rights and liabilities of the registered dealer apply both to the representative personally and the registered dealer as well. The notification of ceasing the representation has to be submitted to the VAT authorities within 14 days after the representation ceases, during which time the foreigner is required to appoint a new representative.

9.3. Liabilities in chain transactions, and other special enforcement situations (e.g. abuse of law provisions)

The Israeli Tax Authority has wide-ranging powers to counter VAT evasion, including measures to combat missing trader fraud. Among those powers are: the authority to audit records or to investigate and, according to the findings, to issue assessments and to sue in criminal courts; to double the amount of the VAT involved in the evasion; and to impose administrative fines.

In a case in which an audit or an investigation indicates that tax invoices were issued unlawfully, with the aim to evade tax, the Tax Authority has the authority to issue assessments to both the seller and the recipient – and to impose on both of them the doubling of the VAT amounts included in the false invoices.

10. Administrative matters

10.1. Registration and VAT number

The registration for Israeli VAT can be carried out by a taxpayer by approaching the regional VAT office, where he will identify himself and to submit registration form “No. 821” if the registrant is an individual, or forms “No. 821” and “No. 821a” if the registrant is a partnership or a corporation. In such a case, at the end of the registration process, which can last anywhere from a few minutes to couple of hours, the registered dealer will receive a temporary certificate of the registration. A final certificate will be sent by post.

Alternatively, the taxpayer can request that a certified accountant or a certified tax advisor registers on his behalf. An accountant or the tax advisor, who has access to the Tax Authority’s computer system can carry out the registration electronically, and within a few days after filing the forms electronically will receive an approval or a rejection (with the rejection’s rationale).

To register as a nonprofit organisation or as a financial institution the taxpayer is required to submit the appropriate forms to the regional VAT office, and it may take anywhere from a few days to a few weeks to receive a reply.

10.2. Invoices

10.2.1. Invoicing requirement

The Israeli invoicing regime requires the issuing of a transaction invoice to the recipient of a supply, and enables a registered dealer to issue a tax invoice instead of a transaction invoice. On the other hand, if the recipient of the supply is a taxpayer it has the duty to demand a tax invoice, and then the mentioned right to issue a tax invoice (by the supplier) changes to the liability to do so. The differences between a transaction invoice and a tax invoices are in the details that each includes, as the tax invoice is more detailed.

If the tax point is on a cash basis the invoice must be issued within seven days from the payment day. In other cases the invoice must be issued within 14 days from the tax point.

10.2.2. Form and information

Only special tax invoices designated for a transaction between Israelis and Palestinians are required to be issued using the official form that is prepared by the Tax Authority. All other invoices may be issued in any format, provided that the following details are included:

- The printed wording “Tax Invoice”;
- The invoice’s unique identifying number;
- The name of the supplier, its VAT registration number and its address;
- The date of issuing the tax invoice;
- The name and address of the person to whom the goods or services are supplied; and
- A description of the goods sold in some detail or a description of the rendered services, with unit price, number of units, VAT rate, VAT-exclusive price, any discount applicable and total VAT charged.

10.3. Returns

10.3.1. Timing for filing

Under Israeli VAT law, each dealer, other than exempt dealers, has to submit periodical returns. The period included in each return is either one month or two months – depending on the turnover from its business in Israel during the 12-month period ending on August 31 of the preceding tax year. If the turnover exceeds the amount of NIS910,000 the period for each return is one month. Otherwise, the period for each return is two months. The returns are required to be filed anytime during the 1st to the 15th of the following month. Exempt dealers have to submit an annual return.

10.3.2. Electronic filing

In general, electronic filing of VAT periodical returns and electronic payment of VAT is now an available option but not compulsory. Most of the Israeli dealers (in general – dealers whose annual turnover exceeds the amount of NIS2.5 million) are required to add to the periodical return a detailed report, which must include mandatory details specified in all of the input and output invoices issued to the business or by the business in the declared period. A delay in the filing of the detailed report will incur a penalty of NIS217 for every two weeks of delay, or part thereof.

10.3.3. Timing of payments or deposits

Under Israeli VAT law, payments arising from the periodical returns must be made at the time of the filing of the returns. Payments must be made by the 15th of the subsequent month of the declared period together with the filing of the return.

A financial institution, which is liable to profit tax on an annual basis, is required to pay advances each month at the rate of 28 percent of the advance required to be paid according to the Income Tax Ordinance.

Payments of wages tax made by a financial institution or nonprofit organisation are required to be paid by the 15th of the subsequent month in which the wages were paid.

10.3.4. Methods of payment or deposit

Israeli VAT can be paid either electronically via a credit card or at most of the banks located in Israel. The electronic payment is capped at the sum of NIS15,000 or NIS25,000, depending on the type of credit card.

10.3.5. Recordkeeping

Israeli-registered dealers must keep business and accounting records, a VAT account showing the calculations of the VAT liability for each VAT period, all invoices received, and copies of all invoices issued. These records must generally be retained for seven years.

10.3.6. Other matters

A person cannot register with the Israeli VAT authorities if they do not have a bank account in Israel.

10.4. Appointment of tax representative

As described above, a foreign person who sells assets or provides services in Israel is obliged to appoint a VAT representative whose permanent place of residence is in Israel.

For further details on this VAT representatives see Section 9.2.

10.5. Audits, e-audits

The officials of the Israeli Tax Authority have wide powers to audit financial and other records in order to confirm that the correct amount of tax has been paid. Triggers to commence a VAT audit include the following: continuation of an investigation, random audit, suspicion of improper behaviour, and requests for refunds.

Planning point: Regular audits are not common. But, some favourite topics are common – among those are: false invoices, services provided to non-Israeli entities and other zero-rated transactions, the deduction of input tax (especially by holding companies) and from time to time a selected industry is subject to audits.

10.6. Appeals of assessments

Under Israeli VAT law, a person who disputes an assessment has the right to submit a contestation to the office that issued the assessment, and the assessment will be reviewed by someone that did not issue the assessment. If the dispute is not resolved following the contestation process, the dealer may appeal to the relevant district court. The court's decision is appealable to the Supreme Court.

10.7. Administrative rulings

Upon request of a taxpayer or its representative, the Israeli Tax Authority issues pre-rulings. The Tax Authority is willing to issue rulings if the subject matter is forward-looking and not a clearance of past behaviour. Most of rulings are a kind of a contract between the taxpayer and the tax authority, and the taxpayer is obliged to fulfil the terms and conditions included in the ruling.

10.8. Cross-border assistance and co-operation

The Israeli Tax Authority is party to treaties and other international agreements that deal with the exchange of information between parties in the context of income tax and customs, but not in the context of VAT.

11. Interest and penalties

11.1. Interest (on underpayments)

Under Israeli VAT law, any late VAT payment is subject to the addition of linkage differentials, and interest at the rate of 4 percent for the late period.

11.2. Penalties

Under Israeli VAT law, a late filing of a VAT periodic return triggers the penalty of NIS217 for a delay of two weeks or part thereof. In addition, any late payment triggers an arrears fine of 0.2 percent for each week of delay.

Notwithstanding the above, if a dealer failed to keep account books or if they kept those books in substantive deviation from the legislative provisions during a certain period (the default period), a fine equal to 1 percent of the turnover during the default period may be imposed on the dealer.

12. Statute of limitations

Under Israeli VAT law, VAT assessments cannot be made more than five years after the end of the relevant tax period. However, in cases in which the taxpayer has been convicted or a payment was made which replaces a criminal lawsuit, for an offense of giving false information, the period is extended to 10 years.

13. Special regimes or arrangements

13.1. Sale of a going concern

Under Israeli VAT law, a transfer of a business as a going concern, which consists of the sale of shares, is not regarded as a VAT transaction and therefore VAT is not due. Nevertheless, if such a transfer of a going concern consists of the sale of assets and liabilities, the sale is subject to VAT. However, if the purchaser is a foreigner, the zero VAT rate may apply when the assets (tangible and/or intangible) are exported.

13.2. Bad debt relief

VAT Relief of bad debts can be claimed in Israel, if various conditions are met:

- It has been proved to the satisfaction of the certified official that a debt became a bad debt;
- A period of at least six months and not more than three years has elapsed since the date the tax invoice was issued;
- A credit tax invoice was issued lawfully to the debtor; and
- The issuer of the credit tax invoice has to submit to the officials a written notice regarding the transaction which caused the bad debt.

If the official is not convinced that the debt became a bad debt, he may issue an assessment, and all regular procedures regarding assessments would apply.

13.3. Other special regimes

Israel recognizes two special VAT regimes – Margin schemes and Eilat free trade zones.

Margin schemes

Most of the transactions made by dealers are liable for VAT on the full sale price. However, with respect to a number of activities, the VAT liability is applicable solely on the profit margin, as follows:

- The sale of used (second-hand) furniture and household utensils;
- The sale of coins, medals and specific gold bars;
- The sale of used private cars;
- The sale of a second-hand dwelling unit (in some circumstances); and
- The sale of securities or other negotiable instruments (which are not included in the definition of “goods”), made by a dealer whose business is the sale of such assets.

Eilat free trade zone

The city of Eilat is located in the most southern part of Israel and unsurprisingly, a large portion of the economy in Eilat is tourist-based. In order to encourage the tourism in Eilat a special law, The Eilat Free Trade Law was legislated. Under this law all transactions taking place in Eilat, made by residents of Eilat are exempt from VAT, including: sales of real estate located in Eilat; sales of goods in Eilat for consumption in Eilat; services provided in Eilat, regarding assets located in Eilat or events taking place in Eilat. Therefore, the sale of goods to a dealer who is registered in Eilat is zero-rated.

14. State, provincial or local indirect taxes

14.1. General information

State, provincial or local indirect taxes – General information

The Israeli VAT Law is applicable to the entire territory of Israel. There are no separate state, provincial or local indirect taxes.

14.2. Registration

State, provincial or local indirect taxes – Registration

There are no state, provincial or local indirect taxes in Israel, and therefore no state, provincial or local registration rules.

14.3. Place of supply (or equivalent)

State, provincial or local indirect taxes – Place of supply

There are no state, provincial or local indirect taxes in Israel and therefore no place of supply rules at the state, provincial or local level.

14.4. Valuation of supply

State, provincial or local indirect taxes – Valuation of supply

There are no state, provincial or local indirect taxes in Israel, and therefore no state, provincial or local rules on valuing supplies.

14.5. Tax rates

State, provincial or local indirect taxes – Tax rates

There are no state, provincial or local indirect taxes in Israel, and therefore no state, provincial or local rates on indirect tax.

14.6. Recovery of input tax

State, provincial or local indirect taxes – Recovery of input tax

There are no state, provincial or local indirect taxes in Israel, and therefore no rules for recovery of state, provincial or local indirect taxes.

14.7. Timing for filing and payment of VAT

State, provincial or local indirect taxes – Timing for filing and payment of VAT

There are no state, provincial or local indirect taxes in Israel, and therefore no timing rules.

15. Appendices

15.1. Exempt and zero-rated goods; goods subject to reduced or enhanced rates

The full list of exemptions and zero-rated items can be found in *Chapter Four: Nil Rate and Exemption in the General Regulations*.

15.2. Key websites

- *The English website of the Tax Authority*
- *List of VAT Regulations in English*

15.3. Relevant forms

No forms are available online.

15.4. Information for state, provincial or local indirect taxes

There are no state, provincial, or local indirect taxes in Israel, and therefore, no information is provided in this section.

15.5. Other

No further information provided.