Real Estate Property Tax in Israel and Tax Incentives for Foreign Direct Investors Investing in Israel

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China and Israel

Israel and China, greatly differ in size and population, but share many challenges – of which providing affordable housing to its residents is a key challenge. This year China and Israel will celebrate 20 years commemorating the establishment of its diplomatic relationship[1]. Although the Jewish people have a long lasting history of 4,000 years, the State of Israel is a relatively young state founded in 1948. Israel is a western style democracy, located in the Middle East, on the east cost of the Mediterranean Sea, and home to 7.5 million citizens. With a size of 22,700 square kilometers, Israel is smaller than the combined size of Beijing and Shanghai.

In the following article, I will present the major real estate related taxes that are levied by the central and local government and the recent regulations issued to cool down the real estate market. I will also briefly introduce the tax incentives offered by Israel to foreign investors, which also include investment in the real estate industry.

Real Estate Capital Gains Tax

Real Estate Capital Gains Tax[2] is imposed on the capital gains earned due to the increase of the value of the property. Israel offers to its residents many exemptions from capital gains, making the investment in the real estate industry exceptionally attractive to investors from a tax perspective. For example, an Israeli resident may be exempt if he

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[1] Diplomatic relationship established in January 1992. The Israeli Ministry of Foreign Affairs, available at http://www.mfa.gov.il/MFA/MFA+events/Around+the+world/Israel+and+China+mark+15+ye ars+of+diplomatic+relations+24-Jan-2007.htm (last reviewed on May 7, 2010.)

[2] Israel Real Estate Tax Law (Appreciation, Sell and Purchase), 1963.

used the apartment for residential purposes and has not sold an apartment during the last four years (if he/she owns more than one apartment) or during the last 18 months (if this is their only apartment).

Due the extensive exemptions mechanisms, the vast majority of sales of residential properties by individuals in Israel are fully exempt from this tax.

The current rates of appreciation tax applicable to a sale of real estate by an individual, which is not exempt for one of the reasons mentioned above, depend on when the property was purchased. The base rate for individuals until November 7th 2001 was 45%. After November 7th 2001, the rate was reduced to 20% but only in relation to that part of the capital gain that accrued following that date.

Corporations are assessed appreciation tax in accordance with the corporate income tax rate, 24% in 2011 and it is expected to decrease to 18% in 2016 (1% percentage each year).

In addition, certain deductions (e.g. certain expenses for improving the property, estate agents' fees and legal fees) are allowed to reduce the capital gain that is to be taxed upon presentation of tax invoices for the payments.

In order to encourage real estate owners to sell their property, the Israeli Ministry of Finance further expanded the exemptions from capital gains tax on apartment sales. Individuals in Israel can sell two apartments during the years 2011-2012 with tax exemptions subject to certain circumstances such as, the value of the apartment does not exceeds 2.2 million NIS ($649,638). If the value of the apartments exceeds 2.2 million NIS ($649,638) the seller will be entitled to a partial exemption calculated according to the provisions of the law, providing other incentives for owners to sell their apartment free of capital gains tax.

Purchase Tax

Separate from the Real Estate Capital Gain Tax, Israel imposes on buyers of real estate rights a Real Estate Purchase Tax that varies according the value of the property as provided in Table 1 below.

To avert the development of a housing bubble, the Israeli government has decided to increase the purchase tax on investment apartments, classified as the acquisition of a second or third apartment. This measure will be valid for two years.

Table 1: Real Estate Purchase Tax

Property Price	New Tax Rate
0- 296868 USD (RMB 1,874,950)	5%
296868 USD (RMB 1,874,951) - 890604 USD (RMB 5,624,850)	6%
890604 USD (RMB 5,624,850) and higher	7%

However, if the property is the purchaser's only residential property and the purchaser had purchased the property during the period starting from February 21, 2011 until December 31, 2012, then the purchaser should be subject to a lower tax burden as provided below.

Table 2: Real Estate Purchase Tax for Single Property Owners

Property Price	Tax Rate
0- 400771 USD (RMB 2034198)	0%
400771 USD up to USD 475348 (RMB 2034198 up to RMB 2858867)	3.5%
Remaining Balance	5%

The property cannot be registered in the buyer's name until the purchase tax has been paid, thus demonstrating the importance of the purchase tax to the Israeli tax code.

Betterment Tax

This is a tax paid when the authorities allow a change of zoning for a neighborhood, which causes the value of the property to rise. The tax is 50% of the added value to the property (as assessed by an assessor) due to the change in zoning.

An example of betterment tax levied is when agricultural land is changed to residential land. Another example is when the building rights to a house or building are increased, allowing the owner to build an addition to the house.

The betterment tax is paid when the owner sells the property or when he requests a building permit.

In order to encourage new construction, the government announced short-term measures, which are also aimed at easing the surge in property prices by offering tax breaks from 2011 to accelerate new construction and cope with the problem of a shortage in the supply of housing.

As of January 2011, the government is reducing the betterment tax rate on private land bought before 2001 from a maximum of 45 percent to 20 percent for a limited period.

Contractors will also be entitled to a 15 percent rebate on the price of land tenders issued by the Israel Land Administration if they finish construction of at least 80 percent of apartments in a project in a period of time of not more than 30 months. [3]

Income Tax On Rent

In addition to the Capital Gains Tax, Purchase Tax, and the Israeli Income Tax, authorities also charge income tax on rent received by a landlord. In residential properties, the first 4,680 NIS in 2010 (US $1,382) a month is exempt from income tax. Any amount above 4,680 NIS in 2010 a month is taxable according to the landlord's income tax bracket (top rate being 45%).

Rents on commercial properties are taxed according to the income tax bracket (top rate being 45%) (including the first 4,680 NIS a month) minus recognized deductible expenses. [4]

Individual can also choose to pay a final tax rate as 10% of the gross income from renting residential property (in case the income from the rent is not recognized as business income)

Municipal Taxes

The Municipal Tax, *Arnona*, is the tax levied on buildings in Israel, both commercial and residential by the local municipality. The Municipal Tax is calculated on the basis of the size of the property, the area in which it is situated and the purpose for which the property

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[3] Tax Changes For the Israeli Real Estate Market in 2011, available at http://www.buyitinisrael.com/israel-real-estate-tax-changes-2011/

[4] Real Estate Taxes You Need to Know About, available at http://www.israelnationalnews.com/Special/Real.aspx/123454

is used. [5]

It is paid once every two months but can also be paid for the whole year in advance. However the tax is not uniform but differs from city to city. Even within the same city, the local authority of each city determines the classification of buildings and neighborhood zoning of cities for the purpose of calculating the municipal tax rate. Property owners or tenants could get charged different rates depending on the neighborhood and type of property and apartment size. Cities are divided into 4 zones because of differing property values within that area.

For example, the local authority of Jerusalem splits the city into four zones for the purpose of calculating municipal taxes for residential housing of apartments with a size of up to 120 sqm. and apartments over 120 sqm.

While some municipalities split the city into zones others charge a flat rate per square meter independent of neighborhood or apartment size.[6]

Foreign Direct Investment in Israel

Israel strongly encourages foreign direct investment and provides various grants, tax incentives, including accelerated depreciation of up to eight years for foreign investors investing in industry, tourism and real estate. For those interested in real estate and tourism, the Israeli government offers incredible opportunities to foreign direct investors in the tourism, hotel and other related industries. For example, a lower corporate tax rate, is illustrated by the table below

China and Israel executed a treaty to avoid double taxation, which promotes international trade, and enables offsetting tax paid in one of two countries against the tax payable in the other subject to certain circumstances. The eligibility and scope of tax incentives and grants may vary according to the location of the investment in Israel. Israel's investment map is divided into two geographic National Priorities Areas. Due to Israel's small

[5]Arnona (Municipal Tax) Reduction, available at http://www.ujia.org.il/aliyah_klita_sections.asp?id=28&back=Rights

[6] Paying Municipal Taxes on Your Home in Israel, available at http://www.buyitinisrael.com/arnona-municipal-tax-in-israel/

geographic size, the areas that receive the preferential treatment can be less than an hour away from Israel's international airport.

Tax Incentives to Foreign Investors[7]

Foreign investors investing in Development Area A which includes Israel's capital, Jerusalem, and the northern and southern part of Israel, may enjoy a reduced tax rate plus governmental grants of up to 30% of the investment. These areas are approximately a one-hour drive from the central metropolis and offer a unique investment opportunity.

Tax Years	Development Area A (Tax Rate)	Rest of the Country (Tax Rate)
2011-2012	10%	15%
2013-2014	7%	12.5%
2015+	6%	12%

Foreign investors that act promptly may even enjoy a ten-year exemption from corporate income tax. Chinese companies as ZTE, Hisense, China Chemicals, and San Hua Holding Group are already doing business in Israel.

Grants of Up to 30 Percent of Investment

According to the Israeli law for Encouragement of Capital Investment, Israel offers several grant programs to foreign investors investing in designated areas. The grant includes up to 24 percent of the original cost of land development, investments in building, machinery and equipment that include installation and related expenses. In certain cases, the grant may reach up to 30 percent of the investment if the investor

[7] Please article does not provide a comprehensive review of the Israeli law for Encouragement of Capital Investment. We highly recommend that you will consult with a qualified Israel tax counsel.

invests in the southern part of Israel[8].

To qualify for the grant, the project must meet certain criteria such as: international competitiveness, minimum designated investment, high added value, and registration of the company in Israel. Investment in Israeli hotels and industry can be a possible investment strategy due to Israel's tax incentives.

Conclusion:

Israel utilizes various mechanisms to levy tax on real estate such as capital gains, local taxes, income tax, and percentages from transaction charges. Israel amends the rates and exceptions applicable when needed, to meet residents and the economy's needs. We are hopeful that this article will assist China in its search for balance in the real estate and housing markets.

About the Writer:

Amit Ben-Yehoshua is senior counsel at Da Cheng Law Offices which has been recently recognized as the largest law firm in Asia.(www.dachenglaw.com). Amit resides in Shanghai, is licensed to practice law in California and Israel and holds a Master's Degree in Chinese law from Tsinghua University of Beijing.. Amit also serves as the China Partner of the Israeli law firm Shibolet & Co. Advocates & Notaries which is among Israel's first tier law firms (www.shibolet.com). Amit has a vast experience in cross border transactions and cultural understanding due to his legal work in Israel, U.S.A and China. Amit is a member of the Board of Directors of the Israel Chamber of Commerce in China and a co-founder and member of the Steering Committee of the Israeli Chamber of Commerce in Shanghai. Amit is also the author of the legal blog Dancing with the Dragon–China Law and Business Update and can be contacted via email at amit.ben-yehoshua@dachenglaw.com or via mobile at + 86-13761360176

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The information provided in this article is for general reference, is partial and incomplete and should not be regarded as legal opinion or relied upon for any commercial purpose. Prior to conducting any transaction, the reader is highly advised to consult with a qualified attorney.

[8] State of Israel, Ministry of Industry, Trade and Labor, Investment Incentives in the Law for the Encouragement of Capital Investment, available at http://www.moital.gov.il/NR/exeres/9DF4F491 -E41C-406F-8903-894F11A502E0.htm (last reviewed on May 8, 2010.)