SWITZERLAND - ISRAEL TAX TREATY RELATIONS

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GENERAL TAX FRAMEWORK IN ISRAEL

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Corporate tax framework

- **General corporate tax rate** is currently **24%** and will be lowered to **23%** in 2018. However, **several tax incentives are available**: (i) Preferred and Special Preferred Enterprise Regimes (ii) Preferred and Special Technology Enterprise Regimes, (iii) Approved Enterprise and Benefitted Enterprise Regime (iv) R&D tax incentives
- **Controlled foreign company legislation (CFC rules):** passive income taxed at less than 15% is a deemed dividend.
- **Participation exemption regime**
- General withholding tax upon payment to a foreign corporation: 24%

GENERAL TAX FRAMEWORK IN ISRAEL

Individual income taxes

- Progressive income taxes (max 47% plus additional surcharge of 3% income higher than NIS 640'000)
- Israel does not levy an inheritance/estate taxes and net wealth taxes
- **General rates**:

  Dividends 25%/30% (for substantial shareholders); Interest 25%; Royalties 25%

  Note additional tax of 3%
- Taxation can be mitigated under tax treaties (notably the Swiss-Israel tax treaty) and various corporate incentives described above
- Special tax regime applicable to **trusts and foundations**. In essence, any structure which has Israeli resident settlor or beneficiaries may be qualified as a resident structure and may be taxed as such
- Reporting obligation, including upon transfer and receipt of funds higher than ILS 500,000.

THE 2003 SWISS-ISRAELI TAX TREATY

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- Treaty concluded in 2003
- Generally based on the OECD Model Tax Convention with, however, some deviations
- Treaty allocates taxing rights between Israel and Switzerland
- Israel generally eliminates double taxation by crediting Swiss taxes on Israeli taxes (credit method) while Switzerland applies the so-called exemption method except for dividends, interest and royalties

THE 2003 SWISS-ISRAELI TAX TREATY

Main distributive rules	Allocation of taxing rights
Immovable property (art. 6)	Situs principle – standard OECD MC – subject to tax clause for gains (CH)
Business profits (art. 7)	Standard OECD MC
Dividends (art. 10)	Qualifying (10%) holdings (5%/10%), other cases: 15%
Interest (art. 11)	5% (banking loan); 0% (government loans); other cases: 10%
Royalties (art. 12)	5%
Capital gains (art. 13)	Standard OECD MC; see however protocol re change of residence
Pensions (art. 18)	Standard OECD MC

THE *"RECEIVED INCOME"* CLAUSE – ART 5 PROTOCOL

- Art. 5 of the protocol provides, however, that *"... as long as income derived by a resident of Israel from sources within Switzerland* ***is, under the law in force in Israel, subject to tax in Israel only by reference to the amount which is received in Israel, and not by reference to the full amount thereof, or such income is exempted from tax in Israel,*** *the exemption from, or reduction in rate of Swiss tax provided for (with or without conditions) by any article of the Convention shall apply only to the portion of that income which is received in Israel or otherwise subject to tax in Israel"*

- Scope recently clarified by the Swiss Federal Tribunal **in a judgment of 25 January 2017 (ATF 143 II 65)** to the lump sum payment made by a Swiss pension fund to a resident of Israel, who benefited from the special regime applicable to new immigrants. Tax treaty benefits denied.

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TREATY SHOPPING USING INTERMEDIARY/ARTIFICIAL COMPANIES – ART 8 PROTOCOL

- The Contracting States declare that their domestic rules and procedures with respect to the abuses of law (including tax treaties) may be applied to the treatment of such abuses notwithstanding the provisions of any treaty or convention for the avoidance of double taxation.
- It is understood that the benefits under this Convention shall not be granted to a person which is not the beneficial owner of the items of income derived from the other Contracting State.

TREATY SHOPPING USING INTERMEDIARY/ARTIFICIAL COMPANIES

- **Israel:** in particular famous Yanko-Weiss Holdings (1996) Ltd. vs Assessing Officer of Holon case
- **Switzerland**: broad interpretation of beneficial ownership (Federal Tribunal Judgment of 5 May 2015, ATF 141 II 447, Swap case) and treaty general reservation of abuse (Federal Tribunal Judgment of 28 November 2005, 2A.239/2005, ApS case)

RECENT INTERNATIONAL TAX DEVELOPMENTS

RECENT INTERNATIONAL TAX DEVELOPMENTS - ISRAEL

- Just as of November 2015, Israel could enter into information exchange and/or multilateral agreements (beforehand information was exchanged only based on DTAs); but note domestic legislation prerequisites
- Multilateral Competent Authority Agreement singed, ratified and in force, as of August 31, 2016
- Multilateral Convention on Mutual Administrative Assistance in Tax Matters signed, ratified and in force, as of August 31, 2016;
- CRS to be implemented as of 2019, with information available as of January 1, 2018 (no information exchange agreement signed to date)
- Spontaneous exchange and exchange upon request already exists.
- Action Plan on Base Erosion and Profit Shifting (BEPS) – gradual application of the various action items.
- Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS (MLI) was signed on June 7th, 2017; no ratified as yet

THE BEPS MULTILATERAL INSTRUMENT (MLI)

- Purpose of the BEPS Multilateral Instrument (MLI) is to transpose into tax treaties certain BEPS measures, in particular the minimum standard relating to treaty shopping (“principal purpose test”)
- Israel and Switzerland have signed the MLI but Switzerland has not t this stage included its tax treaty with Israel in the list of its covered tax agreements

THE BEPS MULTILATERAL INSTRUMENT (MLI)

- However, both Israel and Switzerland have agreed to tackle treaty shopping via the **OECD principal purpose test:** *«Notwithstanding any provisions of a Covered Tax Agreement, a benefit under the Covered Tax Agreement shall not be granted in respect of an item of income or capital if it is reasonable to conclude, having regard to all relevant facts and circumstances,* ***that obtaining that benefit was one of the principal purposes of any arrangement or transaction that resulted directly or indirectly in that benefit, unless it is established that granting that benefit in these circumstances would be in accordance with the object and purpose of the relevant provisions of the Covered Tax Agreement».***

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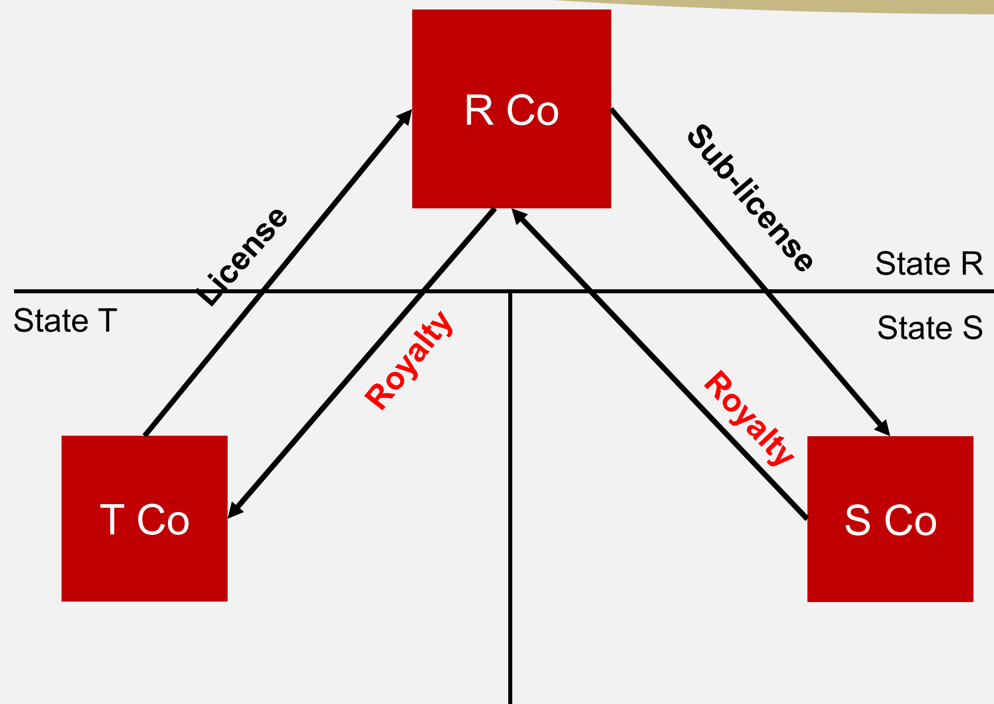
APPLICATION OF THE OECD PPT RULE
IS THIS TREATY SHOPPING ?



- R Co, resident of State R, is a holding company for a manufacturing group
- The group conduct research in its subsidiaries located around the world.
- Once a technology is developed, R Co licenses it from the subsidiary and sub-licenses to other subsidiaries that need it.
- R Co keeps only a small spread so that most of the profit goes to the subsidiary.
- There is no tax treaty between State S and State T.

- Is this an abusive structure ?

OECD PROPOSED COMMENTARIES

- In this example, there is no indication that RCO established its licensing business in order to reduce the withholding tax payable in State S. **Because RCO is conforming to the standard commercial organization and behavior of the group** in the way that it structures its licensing and sub-licensing activities and assuming the same structure is employed with respect to other subsidiaries carrying out similar activities in countries which have treaties which offer similar or more favorable benefits, the arrangement between SCO, RCO and TCO does not constitute a conduit arrangement.

CONCLUDING REMARKS