Your Taxes: The end of 2007 is nigh

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The end of the tax year - December 31 - is fast approaching. Are you in good shape taxwise? Following are a few examples of the many things that may be worth reviewing with your advisers in Israel and any other country where you have a connection.

Businesses - things to consider carefully

The regular rates of company tax are set to decrease from 29% in 2007 to 27% in 2008; 26% in 2009; and 25% in 2010 onwards. Therefore, companies may want to consider whether income can be deferred legitimately to a later year and whether expenses or losses can be accelerated to an earlier year (e.g. by selling slow moving inventory at bargain loss-making prices before the end of the year). This may also be pertinent to securities and real estate acquired before November 8, 2001m in the case of companies.

Check your international transactions with related parties (50% ownership link among other things) are on arm's length market terms before you close your books and their's for the year. New regulations require taxpayers to sign an express declaration to this effect on their annual tax returns. They must also be able to produce a "transfer pricing study" in this regard within 60 days after any demand from the Israeli Tax Authority. If in doubt, consider requesting an "advance pricing agreement" from the Israeli Tax Authority.

On intercompany loan balances in a group of Israeli companies, consider charging interest at 4% p.a. above the rise in the consumer price index - if this is not done there may be deemed income taxable at a rate of 40% for one company under special rules but no expense deduction for the other company.

For intercompany loan balances involving foreign companies in a group, consider charging a reasonable market rate - or perhaps consider an interest-free capital note from a parent company to its subsidiary before the year-end as proposals exist to stipulate a 10-year minimum period starting in 2008, with a 2-year period of grace for capital notes not meeting this requirement if they are implemented before the end of 2007 - but check this carefully with your advisers and the new rules, if and when finalized. Consider the currency of the loan as most countries tax exchange gains. Check also if the balances may be taxed as deemed dividends, e.g. in the US in certain cases. Check if remedial treatment before the year-end may help.

Detailed rules apply to those that carry out long-term work projects lasting over a year - mainly builders. If the builder is a contractor who does NOT own the building, income must be reported this year if the work is 25% complete this year. If the builder is a developer who owns the building, reporting is needed when the building is fit for use. Detailed rules govern the above as well as expenses, finance expenses and losses. A detailed review is obviously necessary ahead of the year end.

Timing may be important for many other things such as: prepaid rental income; replacement of depreciable fixed assets to get a tax deferral or loss deduction; adoption of IFRS accounting standards; offsetting loan interest expense against dividends (see PazGaz & Pi Glilot cases); taxpayers with low taxed controlled foreign companies; taxpayers intending to claim foreign tax credits; businesses allowed to report income on a cash basis; companies required to withhold tax from payments in Israel or abroad in order to deduct the payment as an expense; payments to 10% shareholders; payments to provident/pension funds; payment of tax installments including those for non-deductible expenses ("Odfot"); bonus payments; filing lawsuits for bad debts where appropriate; recording company car kilometer clock readings as of December 31, as car expenses are only deductible to the extent the car travels over 9,900 kilometers per year; investing in fixed assets within two to three tax years to claim tax exemptions or tax breaks applicable to a privileged enterprise (industrial or hotel); increasing foreign investment this year in companies owning a privileged enterprise or approved enterprise or an approved property, to help achieve a bigger tax break next year.

Individuals - things to consider carefully

In the case of individuals, the maximum rate of income tax is set to decrease from 48% in 2007 to 47% in 2008, 46% in 2009 and 44% in 2010 onwards. Passive income from dividends, interest and capital gains remain taxable at a rate of 20% in most cases, but various exceptions exist. Consider whether to accelerate business losses into 2007 or defer business income or salary and bonuses till the next year.

There are many other types of year-end tax planning to consider where relevant. Following are a few.

With regard to tax relief for approved provident fund contributions, the maximum "entitling income" taken into account in 2007 is NIS 86,400 in the case of employment income and NIS 122,400 for non-employment income. Consequently, the maximum payments to an approved provident fund that may qualify for tax relief in 2007 are as follows:

***** NIS 8,568 for payments by self-employed persons to a retirement or pension plan to claim as a deduction from taxable income (NIS 122,700 x 7% deduction). An 11% deduction is possible if payments exceed 16% of entitling income.

***** NIS 6,048 for payments by employees to a provident fund to claim a 25% tax credit (NIS 86,400 x 7% limit).

***** NIS 6,120 for payments by self-employed persons to a provident fund and for life insurance (death risk) to claim a 25% tax credit (NIS 122,400 x 5% limit).

***** NIS 4,320 for payments by employees for life insurance (death risk) to claim a 25% tax credit (5% x NIS 86,400).

***** NIS 15,260 for payments by self-employed persons to an approved further education fund (Keren Hishtalmut) to claim a deduction from taxable income of up to NIS 9,810. This is based on maximum income for these purposes of NIS 218,000 in 2007. Payments of 7% are recognized, but 2.5% is not deductible while 4.5% is deductible. Different limits apply to employees and most companies will be aware of them.

Note that no tax credit is granted for life insurance premiums of less than NIS 1,680 in 2007.

More restrictive rules apply to provident fund contributions and further education contributions by major shareholders holding 10% or more of the company concerned.

Charitable contributions to institutions approved under Section 46 of the Income Tax Ordinance qualify for a tax credit of up to 35% if they exceed NIS 380 in 2007, but the contributions will not be recognized if they exceed NIS 4,130,000 or 30% of taxable income, whichever is lower.

US citizens residing in Israel should consider contributing to recognized "friends of Israeli charity" institutions in the US with a view to qualifying for a deduction for US purposes and a tax credit for Israeli tax purposes on contributions not exceeding 25% of taxable income, under special rules in the US-Israel tax treaty.

Anyone with an actual or potential link to a trust (settler, trustee or beneficiary) in Israel or abroad should immediately review all aspects in light of a new Israeli tax regime that was implemented on January 1, 2006.

As always, consult experienced tax advisers in each country at an early stage in specific cases.

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