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ISRAEL'S **LEADING** INTERNATIONAL LAW FIRM

CLIENT UPDATES

Memorandum of Law for the VAT on Activity of Foreign Companies in Israel through the Internet

In April, 2015 we published a [newsletter](#) on a draft circular issued by the Israeli Tax Authority ("ITA") on the taxation of the activity of foreign companies in Israel through the internet (the "**Draft Circular**").

The purpose of the Draft Circular was to clarify the situations in which a foreign company that provides services primarily via the internet would be deemed to have a permanent establishment in Israel ("**PE**"), and consequently to determine the amount of profit that should be attributed to such PE and thus the amount of Israeli taxable income.

In addition, the Draft Circular sets forth those situations in which foreign companies providing services to Israeli clients via the internet should register in Israel for VAT purposes and pay Israeli VAT.

Recently, the Israeli Ministry of Finance ("**MOF**") has taken this issue one step forward and published a memorandum of law for the amendment of the Value Added Tax Law, 5736-1975 ("**VAT Law**") on taxation of activity of foreign companies in Israel through the internet (the "**Memorandum of Law**"). The Memorandum of Law is the preliminary step in the legislative process.

We have set forth below a summary of the Memorandum of Law.

1. A foreign resident that provides Digital Services (defined below) to an Israeli resident ("**Digital Service Provider**") shall be liable for VAT in Israel; however, if the services are rendered to a "Dealer" (as defined under the VAT Law), a non-profit organization or a financial institution, the recipient of the services would be the party liable for paying the VAT. Consequently, the Memorandum of Law focuses on digital services provided to private clients.
2. A Digital Service Provider that is not currently required to be

registered in Israel (by way of appointment of a representative for VAT purposes) will be required to be registered in a separate designated registration, file periodic reports with the VAT authorities and keep the information with respect to its taxable income for a period of 10 years. It's filings, payment obligations and appeal procedures will be those prevailing under the VAT Law in general.

3. For this purpose, Digital Services include the following:

- Communication services, which include services with respect to transmission and reception of signals, words, sounds, images or other information by line, optical fiber, radio or other electromagnetic systems. Communication services include (1) mobile and stationary telephony services, (2) VoIP services; (3) auxiliary services for telephony services, (e.g. messages, call forwarding, etc.); (4) fax; and (5) internet access services.
- Radio and television services.
- Provision of Digital Services, which includes the sale, provision, or transfer of intangible goods via the internet or other electronic network, including: (1) digital product, including software, software modification or upgrading; (2) entertainment products, books, music, gambling, games, TV shows, movies, webcasts and distance learning services; (3) services to facilitate or enable the online activity of a person or a business, including a website or webpage; (4) an automated service provided by a computer; (5) the right to sell intangible goods or services in a digital store (in exchange for consideration); (6) intermediary between buyers and service providers; and (7) content services.

The Memorandum of Law is pending comments from the public and various stake holders. There is no certainty whether or when the Memorandum of Law will become an amendment of the VAT Law, and if so, if the final language of the amendment will be substantially similar to the language of the Memorandum of Law.

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