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New Tax Ruling – The Israeli tax implications for foreign investors operating through an Israeli representative

On February 7, 2018, the Israeli Tax Authority ("**ITA**") published ruling 6631/18 (the "**Ruling**") addressing the issue of when a non-Israeli investment entity will be treated as having a business activity carried out in Israel. Further, the Ruling provides the allocation method for determining what portion of the income of such investment entity will be deemed Israeli taxable income attributed to the business activity.

General

In general, non-Israeli residents are exempt from tax on capital gains derived from the sale of securities of Israeli companies, provided that certain conditions are met, including that the gain is not attributable to a permanent enterprise of the non-Israeli resident in Israel. The term "permanent enterprise" is undefined but as a practical matter should be viewed as a similar to the treaty concept of permanent establishment.

Non-Israeli investors in Israeli or Israeli-related companies often engage Israeli professionals to assist in the investment process. In these situations, the main tax risk is that such service provider may create a permanent enterprise or, in case a tax treaty is applicable, a permanent establishment ("**PE**") in Israel for such investor.

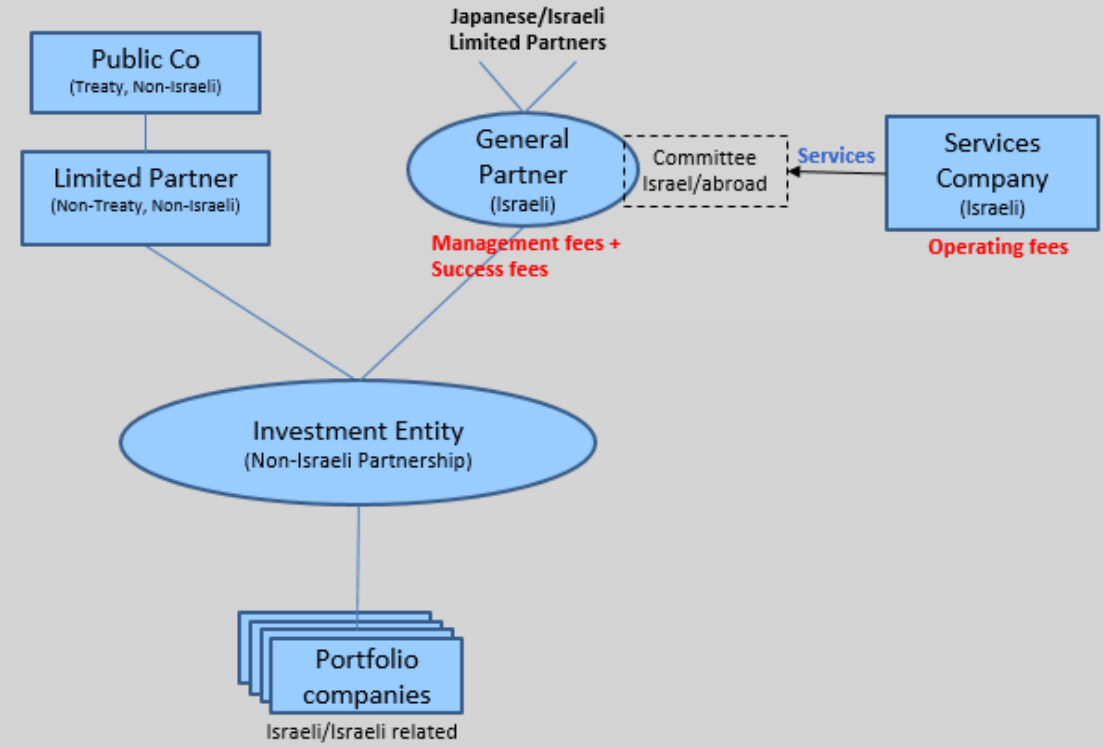
The Ruling

The Ruling (The original ruling, The ruling translation), addresses a case where a non-Israeli partnership (the "Investment Entity") that has only one limited partner, was deemed to have a business activity carried out in Israel with the outcome that some of its income is treated as Israeli source business income.

The Ruling appears to treat the General Partner, the Services Company and/or the Committee as representatives of the Investment Entity with the result that the activity

of the Investment Entity that is performed in Israel was deemed a business activity that generates income in Israel according to the "Cost Ratio" as provided in the Ruling. Importantly, under the specific facts of the Ruling, the Investment Entity did not qualify for the tax exemption arrangement commonly provided to investment funds.

The Investment Entity's structure and the Ruling's facts may be represented as follows:



Summary

1. The Ruling appears to establish a low threshold for treating foreign investors as engaged in business activity carried out in Israel.
2. Based on conversations with the ITA, the ITA has expressed a view that this Ruling is of limited application due to its unique factual circumstances. We believe that the facts of this case are not all that unique and may have broader applicability. We are currently discussing this issue with the ITA.
3. We note that according to the facts of the Ruling, the Limited Partner is resident in a non-treaty country. If the Limited Partner were resident in a treaty country, the applicable treaty should apply to determine whether such Limited Partner has an Israeli PE.
4. While the Ruling reflects the position of the ITA, the Ruling does not have the force of law, and neither taxpayers nor the courts in Israel are bound to accept the position of the ITA as provided in the Ruling.

In our view, the Ruling emphasizes the need for foreign investors that operate in Israel to closely analyze their operations in light of the Ruling. Where appropriate, they should develop strategies and procedures to mitigate any Israeli PE exposure.

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