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Taxation of Foreign Investors in Israeli Investment Funds

Taxation of Foreign Investors in Israeli Investment Funds

(Prepared on the basis of information provided by the Israel Tax Authority)

Investment funds operating in Israel are entitled to approach the tax authorities and receive a pre-ruling with regard to the taxation of foreign fund investors. The approval is, in effect, given to the fund and not to the individual investor. Therefore a foreign investor planning to invest in a fund in Israel should first determine if the said fund has obtained a pre-ruling from the tax authority and if so what exactly the terms of the pre-ruling are.

Taxation of Investment Funds that have not obtained such ruling is usually as follows: Investment funds in Israel are usually established as partnerships and therefore will not be taxed as corporations. Tax will be levied on each one of the partners in the fund. In principle, foreign investors in a given fund will be taxed on the income earned in Israel from the investment fund according to the regular tax rates that are customary as per the different types of income.

There is a distinction between Venture Capital funds and other investment funds as regards the tax benefits for foreign investors.

Venture Capital Funds

The pre-rulings state that the foreign investors in V.C. funds that invest in hi-tech companies, will be exempt from all taxes on their share of income that the fund derives from its investments in companies located in Israel and companies associated with Israel. (e.g. a company originally founded here in Israel but registered in the U.S. for tax purposes with certain activities still located in Israel).

For the V.C. fund to receive such tax exemption status a number of conditions have to be met, namely:

1. The total sum raised by the fund will exceed U.S. \$10.0 million, of which at least 50% will be from foreign investors.
2. The fund will invest at least 50% of the funds raised in "acknowledged investments" (an investment in a company located in Israel or in a company associated with Israel whose main business is "acknowledged activities". "Acknowledged activities" for this purpose are: establishing or expanding plants in Israel involved in industry, communications, information technology, medical technology and biotechnology or Research and Development in these fields.
3. At least 30% of the total funds raised by the fund will be invested in companies incorporated in Israel and that most of their activities are in Israel.

When these conditions are met, a foreign investor transferring or selling rights in the fund will be exempt from Israeli taxation.

Other Private Equity Investment Funds

Generally speaking, the Israeli Tax Authority implements a well established practice of granting tax benefits, including reductions and exemptions, to foreign investors in private equity Investment funds operating from Israel. (Not for investment in real estate) The activity must meet certain

criteria that are determined on a case to case basis in a ruling issued to the fund. The criteria governing the ruling depend on the nature and business of the fund and its investors. Specific information relating to taxation of foreign partners can be obtained from the fund in question, if the fund has already obtained prior approval or directly to the tax authority.

Foreign investors can approach:

The Israel Tax Authority, Directorate for Professional Matters

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