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Certified Public Accountants (Isr)

U.S.-Israel Tax Treaty & The Repatriation Tax

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Basic Treaty Mechanism

- US Citizens (and some Green Card holders) living in Israel are generally obligated to file both Israeli and US tax returns.
- They are subject to taxes on their world wide income.
- Israeli residents may claim a foreign tax credit on their US return for taxes paid in Israel (certain limitations apply).
- Israeli residents may claim a foreign tax credit in Israel for taxes paid in the US (certain limitations apply).
- **The end result should be a tax liability equal to the highest tax rate (Israel/US) for each type of income, and generally no double taxation of income.**

Basic Treaty Mechanism

- The Treaty doesn't limit Israel or the US in introducing changes to their internal tax codes.
- Taxes that are not specified in the treaty may not enjoy the benefit of avoiding double taxation.



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Basic Treaty Mechanism

- Tax rates applicable for each Country.
- Who (Israel/US) taxes the income first – right to “first bite”.
- Utilizing deductions.
- Utilizing foreign tax credits.

The Right to First Bite (Article 26(2) of Treaty)

- Real Estate Rental Income – Location of the property
- **Dividends, Interest, Royalties – Where earned**
- Capital Gains – Country of residence
- Capital Gains from sale of real estate – Location of the property
- **Business Income – Where earned/generated**
- Salary/Employment income – Where earned, unless the taxpayer spends 183 days or more in the other country during the tax year (Section 16)

New Repatriation Tax

- The Repatriation Tax may affect owners of a “specified foreign corporation,” which are any CFC (controlled foreign corporation) or any foreign corporation with a U.S. shareholder. A CFC is a foreign corporation which at any point in the tax year has U.S. shareholders who own or control more than 50% of its stock. Any U.S. shareholder who owns 10% or more of a CFC would be subject to this tax.
- This tax on Israeli tax residents does not contradict the tax treaty (Article 6 (5))
- This new tax is not covered by the treaty, Israel is not obligated and will not allow a tax credit in this case since this is Israeli earned income.
- The result is potential double taxation.



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Article 6 (5)

The United States may impose its personal holding company tax and its accumulated earnings tax notwithstanding any provision tax of this Convention. However, an Israeli corporation shall be exempt from the United States personal holding company tax in any taxable year unless any resident or citizen of the United States owns, directly or indirectly, within the meaning of section 544 of the Internal Revenue Code, 10 percent or more in value of the outstanding stock of the corporation at any time during the taxable year. An Israeli corporation shall be exempt from the United States accumulated earnings tax in any taxable year unless such corporation is engaged in trade or business in the United States through a permanent establishment at any time during such year and at least 25 percent of the voting stock of such corporation is owned by citizens or residents of the United States.

Deductions

- Israel will generally allow actual expenses and will not cap them.
- **The US standard deduction can't be used as a deduction for Israeli tax purposes.**
- **When using the standard deduction in the US, ask your professional to provide a Schedule A of itemized deductions (may be used on your Israeli return).**
- Charitable contributions are used as tax credit (35%) and not as deductions.
- Some US deductions are not allowed – e.g. medical, home mortgage interest.



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Foreign Tax Credits

- Israel will allow - in most cases - a \$ to \$ tax credit for US taxes paid on income taxed by the US in accordance with the Treaty. Tax credit will be limited to the tax rate applicable in Israel.
- Foreign tax credits, not utilized during the current year can be carried forward for five years.
- For foreign tax credit purposes, US taxes should be allocated to the various types of income – specific allocation or average are generally accepted.
- US State taxes may be used as a foreign tax credit.
- The ITA will not permit a tax credit for Medicare tax.

Israeli Tax Filing - Other Considerations

- U.S. Charitable Contributions – subject to certain limitations, can be reported – will generate a 35% tax credit. Does not generally apply to Trusts and Foundations.
- State taxes can be used as a foreign tax credit.
- Don't forget to consider social security/national insurance.
- **Make sure your Israeli CPA/tax advisor as well as your US tax professional are aware of the specific issues related to Israel-US taxes.**

What can be done?

ARTICLE 28: Mutual Agreement Procedure

1. Where a resident or citizen of one of the Contracting States considers that the action of one or both of the Contracting States results or will result for him in taxation not in accordance with this Convention, he may, notwithstanding the remedies provided by the national laws of the Contracting States, present his case to the competent authority of the Contracting State of which he is a resident or citizen. Should the resident's or citizen's claim be considered to have merit by the competent authority of the Contracting State to which the claim is made, it shall endeavor to come to an agreement with the competent authority of the other Contracting State with a view to the avoidance of taxation not in accordance with the provisions of this Convention.



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*This presentation provides general guidelines
and does not provide tax advice.*

*Before making decisions
consult with a tax professional
for specific tax advice.*

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