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Israel

Israeli Policymakers Divided Over Response to U.S. Tax Policy

By Matthew Kalman

Israeli officials are struggling to respond to recent U.S. tax reforms, and pressure is building as tensions rise between America and some of its major trading partners.

The U.S. cut its corporate tax rate to 21 percent from 35 percent as part of the 2017 tax act. The reforms will force American companies with Israeli subsidiaries to pay more in tax, while reducing corporate rates for those based in the U.S.

Snapshot

- Israel could benefit from escalating trade tension between U.S. and China
- Officials still forming response to U.S. tax reform

Some practitioners and officials are concerned the measures could reduce Israel's attraction as a destination for the research and development centers, which have been the backbone of the country's burgeoning high-tech economy and make up about half its industrial exports. Still others say the conflicts between the U.S. and China could open a door for Israel.

"Israel is in a unique situation," Yitzchak Chikorel, a partner and head of international taxation at Deloitte in Tel Aviv, said April 10. "Israel is like a bridge between East and West."

Officials are Split

A committee to devise a response to the U.S. measures comprising representatives of the tax authority, finance ministry, and economy ministry—chaired by Avi Simhon, head of the National Economic Council—is split on what action to take. Many countries, including Australia and Germany, have been looking for ways to respond to U.S. reforms and to encourage investment in their own jurisdictions.

"I ask that we work together, the Economy Ministry and the Tax Authority, to assist Israeli companies in tackling the consequences of the American tax reforms," Economy Minister Eli Cohen wrote April 8 in a letter addressed to the head of the tax authority. A copy of the letter was obtained by Bloomberg Tax.

Cohen's proposals, designed to favor smaller Israeli companies, include renegotiating the Israel-U.S. tax treaty to eliminate withholding tax and dividend tax that companies can no longer deduct from their U.S. liabilities; recognizing accelerated depreciation on capital equipment in the first year; and allowing Israeli companies to deduct the new base erosion and anti-abuse tax which would otherwise encourage them to incorporate in the U.S.

Simhon also wants larger corporations to benefit from any change, ensuring that giants like Teva Pharmaceuticals Industries Ltd. and Intel Corp. remain in Israel, TheMarker reported April 15. The finance ministry and national economic council didn't respond to requests for comment.

Meanwhile, Finance Minister Moshe Kahlon appears to be seeking tax cuts that would resonate with voters as elections near.

No Response Needed

And not everyone is convinced that the U.S. reforms merit a response at all.

"We don't need to do anything," said Uriel Lynn, president of the Federation of Israeli Chambers of Commerce.

"We have today enough tax breaks and tax benefits for companies that would like to invest in Israel and already the tax on companies that are exporting is below the tax level in the U.S.," Lynn told Bloomberg Tax April 15.

Israel Could Benefit

Some observers see opportunities for Israel in the growing tensions between the U.S. and China. On April 3, U.S. President Donald Trump announced a 25 percent tariff on Chinese products like flat-screen televisions and medical devices, on top of a tariff on steel and aluminum. China in response imposed tariffs on U.S. products like pork and wine.

If the U.S. raises customs tariffs for additional goods from China and other countries, Israel could leverage its free trade agreements with the U.S., China, the European Union and others to become a way-station for items from those jurisdictions to be re-exported to the U.S. tax-free as goods of Israeli origin, Deloitte's Chikorel said.

If 35 percent of the value is added to goods in Israel, they are considered to be of Israeli origin and are subject to the reduced customs regulations.

“Maybe there is a huge opportunity here,” Chikorel said. “There are some European companies that already use it. Everyone knows about it. It's legitimate.”

Only a few companies, mainly in the textile industry, have taken advantage of the opportunity, which has been available for 30 years, said Eric Sherby, founder of Sherby and Co. law firm in Ramat Gan.

“Who wants to invest if you think your only window is created by a political skirmish which could be resolved politically in the short term?” Sherby asked April 16. “Even if you're dealing with companies that are in the field, to invest in the infrastructure to take advantage of a market that is now open but you don't know for how long—that's a risk.”

Chinese companies haven't exported to the U.S. through Israel in the past, Lynn said. “We'll have to wait and see if there is a real interest in that,” he said, warning that “the U.S. will have to react.”

Israel could also benefit if the U.S. begins restricting Chinese investments, Arie Reich, a law professor at Bar-Ilan University, said April 15. “They are looking for technology and know-how.”

In the past five years, Chinese investors have accounted for some $15 billion of the approximately $25 billion invested in Israeli technology, said Edouard Cukierman, chairman of Cukierman & Co. Investment House Ltd. and managing partner of Catalyst Investments in Tel Aviv, who is convening a major Israel investment conference in Hong Kong and Foshan in May.

“Obviously we are not happy about the tension between China and the U.S. but Israel is an interesting alternative for Chinese groups that are looking for innovative technology companies,” Cukierman said April 16. “We see more and more interest from Chinese companies to look at the innovative technology companies in Israel while it becomes more complicated for them to buy companies in the U.S. and also in Europe. We see that trend as a positive trend for the Israeli high tech industry.”

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