The New Double Tax Treaty between Germany and Israel

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On August 21 2014 the Finance Minister of Israel, Yair Lapid, signed with his German counterpart, Wolfgang Schäuble, a new tax treaty for the avoidance of double taxation.

At the present the two countries do have a double tax treaty in place since 1967 with changes instituted in 1977. The new tax treaty is intended to further encourage bilateral trade and investment between Israel and Germany. Following the ratification the new signed tax treaty is expected to take effect at the beginning of 2015.

The new tax treaty is mainly based on the standard Model Tax Treaty of the Organization for Economic Co-operation and Development.

With respect to the maximum rates of withholding tax the new treaty determines the following:

- **Dividend:** In general there will be a maximum withholding tax on the distribution of dividends of 10 %, and 5 % if the beneficial owner is a company (other than a partnership), holding at least 10 % of the capital of the company paying the dividends. This is a substantial reduction of the withholding tax rate of 25 % according to the current tax treaty.

  The new treaty contains a special provision for the distributions made by real estate investment companies where the source state is generally not limited to tax the distributions of dividends at source, except where the beneficial owner holds directly less than 10 % of the company making the distributions. In this case the limitation of withholding tax is up to 15 %.

  Interest: The maximum withholding tax rate for interest will be in general 5 %, subject to exceptions. Also with respect to interest payments the new tax treaty provides a significant reduction of withholding tax rate compared to the current tax treaty, where the rate is 15 %. The new treaty underlines that the term "interest" does not include elements of payments additional to the sales price arising from the sale on credit of any merchandise or industrial, commercial or scientific equipment.

- **Royalties:** With respect to tax on royalty payments the new treaty adopts the standard of the Model Tax Treaty of the OECD and exempts the tax at source.

  With respect to **capital gain** – the new treaty adopts the principal of the Model

Tax Treaty of the OECD according to which capital gain is exempt in the source state, unless the gain arises from the sale of real estate or the sale of shares in a company considered a real property company, meaning that the value of the company is more than 50 % derived from immovable property. The latter does not apply to the sale of shares in a partnership. An additional rule provides that in case where a resident has become a resident of the other State, the former state may tax accrued capital gains attributable to the property at the time of change of residence.

In connection with **Pensions, Annuities and Similar Payments** the new treaty - for the first time - explicitly states that compensation to victims of the Nazi Regime (including restitution payments) is exempt from tax both in Israel and Germany.

In line with the Model Tax Treaty of the OECD the new treaty also includes provisions for the **Elimination of Double Taxation**, a **Non-Discrimination** clause, **Mutual Agreement Procedure** and a provision for the **Exchange of Information.**

As a result, the Israeli Tax Authority can ask its German counterpart for information that might help it discover violations of Israeli tax law – and vice versa. This is part of the general drive in cracking down on “black” capital.

To avoid double taxation Germany generally provides for the exemption method. However, dividends shall be exempt only to the extent they are distributed by a company resident in Israel in which the German recipient company directly holds at least 10 % of the capital and while the dividends are not deductible in Israel. The credit method applies to a number of specifically listed types of income. In contrast, Israel generally provides for the ordinary credit method for the elimination of double taxation.

In summary the new tax treaty with the exchange of information clause can result in more exchange of information requests between the tax authorities of both countries. The substantial reduction of withholding tax rates may make direct investments from Israel into a German company a more feasible and attractive alternative than under the current tax treaty.