

Relocation to the US – An Israeli Income Tax Perspective

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Israeli residents relocate abroad for a variety of reasons. Lately foreign or multinational companies want to relocate their Israeli employees to the US, so that they can provide services, know-how or give instruction or explanation for the use of devices directly to their worldwide customers. In connection with the relocation, a variety of questions may arise: like for example Visa –questions, how to find and rent an apartment in the US or how to open a bank account. In addition to these questions Israeli Income Tax or Social Security implications as well as questions about potential tax benefits upon return to Israel are important and crucial aspects in connection with the relocation.

This newsletter by a boutique tax law office in Israel focuses on the income tax issue of the relocation from an Israeli perspective.

Since 2003 Israeli tax is based on the taxation of worldwide income if the person is Israeli tax resident. The key question is how to determine “residence” for income tax purposes and at what point in time residence is lost or broken.

For Israeli tax purposes, an Israeli resident is defined as an individual whose “center of living” is in Israel. To determine the center of living, qualitative considerations are taken into account, like the place of employment, family links, and habitual residence, economic and social ties. To establish residence according to the Israeli Income Tax Ordinance, not all, but the majority of links enumerated must be in Israel.

This qualitative test to determine the center of living contains also a subjective component, according to which one has to inquire, what is the intent of the taxpayer and where does he see his center of living.

These objective and subjective criteria are determined in real time and not retrospective. Therefore it is important to plan ahead before relocating to the US.

In addition to these qualitative considerations to determine the center of living the Israeli Income Tax Ordinance also provides for a quantitative criteria test - a number of days test.

A presumption of Israeli residency will apply if the individual is present in Israel at least 183 days in a tax year ending December 31, meaning that an individual present in Israel for 183 days or more is presumed to have his center of living in Israel. This presumption can be refuted although with the heaviest burden of proof. Another number of days test is based on a three year period, according to which the individual is present 425 days cumulative in the current and two preceding tax years and at least 30 days in the current tax year. Also this presumption can be refuted.

For example an individual leaves Israel in August 2015 for work in the US. In the tax year 2015 the individual is present in Israel more than 183 days. The center of

living is presumed to be in Israel for the year 2015. This presumption can be refuted.

Another example would be if the individual leaves Israel in April 2015 and does not visit Israel anymore in 2015. Since the individual stays in Israel more than 30 days in 2015, and probably 425 days cumulative in 2015, 2014 and 2013, the individual is presumed to be a tax resident in Israel for the whole calendar tax year 2015, even though he left to the US already in April. This presumption can be refuted.

One has to emphasize that even if an individual fails to meet the number of days test and might be considered nonresident under the numerical test, the tax authority can disprove based on factual circumstances and argue that the center of living is nevertheless in Israel.

From the above it is clear that an individual who intends to leave Israel to work in the US must plan ahead and have a proper tax plan in place before relocating. The determination of residence is crucially important. The taxpayer should avoid to find himself in the situation that after years of work in the US and paying taxes on his income in the US, he is presented with a tax assessment in Israel because he is considered Israeli tax resident under the Israeli Income Tax Ordinance while and during his work in the US.

To avoid this scenario, an individual who decides to relocate to the US for work should try to make a clear cut break to his Israeli tax residence.

First of all he should visit Israel, especially in the beginning, only for a short period and count the days staying in Israel. He should try to have the least economic and social links in Israel. A factual strong circumstance to prove the break of Israeli tax residence is the sale of the apartment or house in his ownership or at least a long term lease agreement to show that no habitual abode is available for use and disposal every time the taxpayer visits Israel. Also advisable is to cancel a membership in a sports club, museum or theatre to show that one breaks with social ties in Israel. He should also sell his car before moving to the US. The individual should instead establish social and economic links abroad, for e.g. membership in a local sports club or in the Jewish community and live abroad in a rented or owned apartment which is entirely at the individual's disposal.

According to the latest court decisions in Israel, the fact that someone leaves a bank account in Israel, or has a pension plan in place with an Israeli Insurance Company, or even makes payments to the Israeli Social Security Institution in order to enjoy the continuity of the insurance and health care, would not be enough to determine that the center of living remains in Israel. He will be considered to have transferred his tax residency to the US when the majority of family, economic and social ties are in the US.

A more complex question is to determine the point of time when a taxpayer is considered to have changed his tax residency for income tax purposes. The change of links happen normally gradually and not with the stroke of a sword. According to a Circular by the Israeli Tax Authority of 2012, an individual stops being an

Israeli tax resident if he is at least 183 days outside Israel in the tax year in question and in the following year (period of 2 years) and has his center of vital interests outside Israel in the following two years. The tax authority therefore apply a four year test. Only if the taxpayer satisfies this four year test, he will be deemed resident abroad for the entire four year period (from day one). According to this administrative Circular, a taxpayer who stays abroad for work for only two years, cannot satisfy the non-resident test of this Circular and he will be considered Israeli tax resident for the whole two year period. In contrast to this Circular, the District Court of Haifa has recently decided, October 2014, that an individual might stop being Israeli resident even if he stays abroad less than 3 years (from day one). In addition this recent court decision shows and emphasizes again that the residency of an individual cannot be determined on an automatic basis but that every case must be examined individually and profoundly to determine where a person's center of life is.

It is essential to plan and seek advice before relocating to the US. Besides questions about the continuance of Israeli Social Security payments or tax implications with respect to Israeli retirement or savings plans, the question whether and how to leap out of Israeli tax residence is crucial: Planning ahead and proper will save unnecessary payments and avoid double taxation.