

Taxation of Israeli apartments leased by foreign residents

A combination of factors, including favorable tax policies, is building strong real estate ownership by foreign residents.

19 September 10 14:7, Yuval Navot

In recent years, we have witnessed an unprecedented foreign investment in the Israeli real estate market, particularly in residential assets. A report published by the Ministry of Finance earlier this year indicates that in 2009, foreign investment in residential assets amounted to NIS 4.3 billion. The report also indicates that in Jerusalem, Eilat, and Netanya, foreign residents purchased 6-11% of all apartments purchased in 2009, and that in the luxury apartments' market the numbers are even higher 30% in Jerusalem and 10% in Tel-Aviv.

Some of the reasons for these sizeable investments are the economic downturn in the global financial markets, record-low interest rates, prosperity in the Israeli real estate market, an increase in anti-Semitism expressions, and the desire of many foreign individuals to own a piece of real estate in the holy land.

There are also some good tax reasons.

The UBS saga, and new exchange-of-information agreements, may have freed up a lot of cash that was withdrawn from undisclosed bank accounts in Switzerland and other countries. In addition, Israeli tax legislation provides substantial tax incentives for investment in residential real estate. Specifically, a gain realized on the sale of the property is generally tax-exempt, and rental income is subject to minimal taxes and limited reporting obligations.

Generally, the net rental income is subject to ordinary income tax rates. The top ordinary income tax bracket is currently 45%. In calculating the net rental income, deductions such as depreciation and mortgage interest, are allowed.

If the residential rental income is not part of the foreign lessor's active business, the lessor may elect to apply one of the two following beneficial alternatives.

Under the first alternative, there is an exemption which is limited to monthly gross rental income of NIS 4,680 (approximately \$1,250). Any rental income in excess of NIS 4,680 erodes the exemption by the amount of such excess. So if, for example, the rental income is NIS 7,000, the exempted rental income would be only NIS 2,360 (4,680 minus the amount of the excess of 7,000 over 4,680). Importantly, there is no filing or reporting obligation to the Israeli Tax Authority assuming the entire income benefits from the exemption.

Under the second alternative, there is a 10% tax on the gross rental income. So again, no deductions are allowed. There is no cap on the amount of rental income that benefits from this reduced tax rate. The tax due should be paid by January 30th of the following year. Technically, the foreign lessor is subject to a tax return filing obligation. However, in practice, it might be possible to pay the tax along with a short Revenue form that

currently exempts Israeli residents earning rental income of up to NIS 311,000 from the return filing obligation.

It is also worth mentioning that under the tax treaties between Israel and certain countries, such as France and Sweden, these countries may not tax their residents on their Israeli rental income. So in these cases, there would be no additional tax in the lessor's residence country.

The author is a US and Israeli tax lawyer with Elieser Kaplan Law Offices.

Published by Globes [online], Israel business news - www.globes-online.com - on September 19, 2010

© Copyright of Globes Publisher Itonut (1983) Ltd. 2010