14 November 2019
Global Tax Alert

Israel ratifies II protocol of treaty with UK – changes will be in force as of 1 January 2020

Effective 1 January 2020, a number of changes to the double tax treaty between Israel and the United Kingdom (UK) will come into force. These changes have significant affect for companies and individuals performing Israel-UK cross-border business and transactions, and introduces additional anti-avoidance clauses, including a Principal Purpose Test (PPT) consistent with the Base Erosion and Profit Shifting (BEPS) proposals of the Organisation for Economic Co-operation and Development (OECD), which seeks to limit the entitlement to treaty benefits where a main purpose of a transaction is to obtain treaty benefits.

It is noted that the changes will come into effect in Israel from 1 January 2020, and in the UK from 1 January 2020 with respect to withholding taxes and from 1 April 2020 with respect to other articles.

The table below summarizes the key changes and actions required for companies.

	Current tax treaty	Update as of 1 January 2020	Actions required
Dual resident companies*	Under the current treaty, a company that is a tax resident in both countries under the domestic laws will be resident only in the country of its effective management.	A company is a tax resident of both countries, until the matter is resolved by a mutual agreement between the Israeli and UK tax authorities.	▸ Identify dual UK/Israel resident entities in a group structure. For example, UK incorporated companies that are controlled and managed from Israel.
Permanent establishment (PE) – expansion of definition*	Standard PE article.	PE article has been expanded so that activities and presence of all relevant entities must be considered together.	▸ Review selling activities in other country considering all presence/activities of relevant companies. ▸ Refresh PE analysis.
Dividend withholding tax	Dividends are subject to a withholding tax of 15%, provided that the dividend income is "subject to tax" in the UK.	The withholding tax rate is reduced to 5% for dividends to a UK company that has at least 10% holding (otherwise, the rate remains at 15%).	▸ Consider delaying a dividend distribution until after 1 January 2020.
Interest withholding tax	Interest is subject to a withholding tax of 15%, provided that the interest income is "subject to tax" in the country of residence of the recipient.	Withholding tax rate is reduced to 10% (5% to a bank). As an alternative, it is possible to elect to apply the standard corporate tax rate on the net interest income. Certain withholding tax exemptions are also being introduced.	▸ Consider delaying an interest payment until after 1 January 2020. ▸ Consider if a net basis of taxation on interest may be beneficial.
Royalty withholding tax	0% rate is imposed on royalty payments (15% * corporate tax rate if related to cinema, televisions, films), provided that the royalty income is "subject to tax" in the country of residence of the recipient.	0% is imposed on all royalties (cinema, television, films – not excluded).	▸ For royalties for cinema, television or films, consider delaying a royalty payment until after 1 January 2020.
Capital gains on sale of shares*	Exemption from tax in the country of the company whose shares are sold, provided that gain is "subject to tax" in country of residence of the seller.	Exemption from tax in the country of source, unless more than 50% of the value of the shares relates to real estate.	▸ Sale of shares in an Israeli company after 1 January 2020 (which is not eligible for the domestic law exemption) may be exempt from tax in the UK and in Israel (provided that the value is not mainly from real estate in Israel).

* Will be in force in the UK as of 1 April 2020.

In light of the above, companies with Israel-UK business should examine the impact of the above changes and consider changes to their business models, as well as the timing of making certain payments.

For additional information with respect to this Alert, please contact the following:

EY Israel, Tel Aviv

- Sharon Shulman sharon.shulman@il.ey.com
- Lior Harary-Nitzan lior.harary-nitzan@il.ey.com
- Alex Singer alex.singer@il.ey.com

Ernst & Young LLP (United States), Israel Tax Desk, New York

- Lital Haber lital.haber1@ey.com

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