



Doing business in Israel 2023

mazars

Introduction

The current state of the Israeli economy

Israel is a country that has long held a reputation for having a strong economy and vibrant commerce. Israel's economy is extremely diversified, with significant economic activities taking place in the agricultural, industrial, high tech, biotech, and financial industries to name a few.

In particular Israel's market economy has embraced technology and the growth potential it offers. Historically, Israel's main imports included oil, mineral fuels, and transport equipment¹, and its leading exports consisted of high-tech equipment and pharmaceutical products².



Introduction

The current state of the Israeli economy

In a post Covid-19 world

As of 2022, Israel's economy has exhibited both growth and contraction. The economy grew at an annualized rate of 4.8% in the first half of the year³. However, in the second half, the economy experienced a slowdown due to various factors such as supply chain disruptions, a deceleration in the high-tech sector, and global economic challenges.

Israel's GDP grew by 6.5% in 2022. According to the Central Bureau of Statistics, Israel's GDP per capita growth in 2022 year was 70% higher than the OECD average of 2.6%, making it the second highest GDP per capita growth rate among the 14 OECD countries studied, after Ireland⁴.

However, the economic slowdown is expected to impact Israel's economy in 2023, with the Bank of Israel's most recent forecast, released in January 2023, predicting GDP growth of 2.8% in 2023⁴.

Inflation has been rising in Israel, which has led to increased interest rates. The Bank of Israel raised interest rates six times in 2022, in an effort to curb inflation and keep the economy stable⁵.

Despite challenges experienced in 2022, there have been some areas of growth in the economy. Numerous companies in Israel have still managed to raise funding for innovative ventures, with a number of high-profile investments and acquisitions. The country's real estate market has also seen continued growth, with consistent demand despite increasing interest rates.

What this means for business

Israel's economy has established its resilience and stability, earning its reputation as the innovation capital with a thriving entrepreneurial spirit, continuing to make it an attractive option for both local and foreign investors. The government further incentivizes investment by providing an array of benefits and incentives that apply to both local and foreign investors.

Laws such as the Law for Encouragement of Capital Investments, which was passed in 1959, are designed to increase Israeli investment by offering tax benefits and grants, particularly to investments made into sectors which strengthen the high-tech industry such as high-tech startups, innovative industries, R&D projects, and programs that encourage seed-stage companies.

These incentives make Israel the ideal place to start, invest in, and run a business. In this brochure we will give you a short summary of some of the main things to be aware of before you begin doing business in Israel.

Business in Israel

General information

Israel is known as the ‘Start-Up Nation’ and has served as the home to the highest concentration of start-ups outside of Silicon Valley. As a result, Israel invests more per-capita in R&D than any other country in the world, and the local stock market has proudly outperformed most indices over the past fifteen years.

Israel deal landscape

Despite the ongoing economic challenges posed by the COVID-19 pandemic, and the outbreak of the Russia Ukraine War, Israel’s deal landscape remained strong throughout 2022. While there were fewer IPO, merger, and acquisition deals than in previous years, the cumulative value of these deals rose significantly. According to data from IVC Research Center, Israeli high-tech companies raised a record-breaking \$14.95 billion through IPOs, M&A and other fundraising activities in 2022.⁶ This includes notable IPOs such as Mobileye and Pagaya, as well as significant investment rounds for companies like Ultima Genomics, Fireblocks and VEEV.

In addition to IPOs and fundraising rounds, mergers and acquisitions remained a significant part of the Israeli deal landscape in 2022. According to the IVC Research Centre, the total value of M&A deals in the Israeli market amounted to \$12.737 billion in 2022. Notable deals included Unity’s acquisition of Iron Source for \$4.4 billion, Kirkbi’s acquisition of BrainPop for \$875 million and the ongoing deal between Intel and Tower Semiconductor for a reported \$ 5.8 billion⁶.

Overall, despite the ongoing economic challenges, Israel’s innovative and resilient high-tech sector continued to attract significant investment throughout 2022, positioning the country as a key player in the global tech industry.

Talented workforce

Israel’s renowned academic system fosters an extraordinarily talented workforce. For example, Israel is ranked No.4⁷ for research personnel and has the highest concentration of engineers and PhDs per capita globally. These unique features lay the foundation for successful research and innovation.

Research and development

Israel is the world’s spiritual hub for innovation and a powerhouse for revolutionary R&D. Israeli

makers, thinkers, and doers are changing the world of Cyber Security, Media & Internet, Water Technology, AgroTech, Health & Life Sciences, Financial Technology, Automotive, High-Tech & Smart Manufacturing.

Technology

Israel’s ground-breaking Advanced Manufacturing technologies offer countless opportunities for high-level industries and products. From 3D printers to Nano Technology to Cyber Security, and of course, financial technology or Fintech, Israel is home to some of the world’s most advanced procedures and industrial technologies.

Sectors of the Israeli economy:

The Israeli economy comprises the following sectors:

- The technology and industrial manufacturing industry, hi-tech industries, which are the fastest growing in Israel, averaging an 8% annual growth per annum in recent years;
- The Diamond Industry in Israel is a leading world diamond manufacturing and trading center;
- Agriculture, despite the scarcity of natural resources, particularly water and arable land;
- Construction, the majority of which is a residential building;
- Transport and Communications, the highest percentage of which relates to land transportation; and
- Tourism: tourists are attracted by Israel’s geographical diversity, archaeological and religious sites, unlimited sunshine, and resort facilities⁸.

Business in Israel

General information

Different business structures in Israel

Reaching the milestone of launching a business is a great achievement, but it is essential for project holders to set out with their main investment's objectives and goals in mind. In order to pick the most suitable business vehicle it is critical to have a clearly defined goal of what you would like the business to achieve. Choosing a business structure in Israel can vary vastly depending on the business' strategy and the degree of independence the Israeli branch of operations will have from the parent company, and whether the company wants to enjoy limited liability for its operations.

Type of business structure	Definition	Features
Representative office of a foreign company	Representative office.	<ul style="list-style-type: none">• Simple structure• No commercial activities• No autonomy
Branch	A branch of the foreign company that can legally bind the company and conduct business on its behalf.	<ul style="list-style-type: none">• No legal personality• Can make decisions independently as the branch's representative in Israel
Subsidiary	Company incorporated under Israeli law that can conduct all types of business.	Autonomous legal entity
Holding company	Company incorporated under Israeli law that can conduct all types of business.	Autonomous legal entity
Partnership	Company incorporated under Israeli law that can conduct all types of business.	Autonomous legal entity





Business in Israel

General information

Individual income tax

Under the current tax laws in Israel, from 2003, Israeli residents have been subject to tax on their worldwide income. Non-residents are taxed on any income derived from Israeli sources (subject to applicable tax treaties). Special provisions are made for Israeli residents who qualify as “new immigrants” or “veteran returning residents.” Regular income is taxed under progressive tax rates based on the extent of the individual’s personal income. Capital gains are generally taxed at a fixed rate of 25% to 33% for substantial shareholders who are individuals.

Corporate income tax

The Israeli corporate income tax involves a two-tier taxation system. The first tier operates at the company level, and the second on dividend distribution. Dividend income is subject to income tax, whether it is earned by either a resident or non-resident. However, exemptions and tax relief are available for certain intercompany dividends. Israeli corporate income tax is based on the company’s net taxable income (profit before taxes) as determined by Israeli accounting principles and adjusted according to the provisions of the Ordinance and the Income Tax Regulations (ITR). Corporate income tax is assessed per annum or for the calendar year. The current corporate income tax rate in Israel is 23%.

VAT

Israeli standard VAT or value-added tax applies to any transaction which takes place in Israel or on the import of goods at a single rate on the price of the product or sum of the transaction. The current standard rate for VAT is 17.0%, below the OECD average of 19.3% (data valid as of January 2021).

Withholding Tax (WHT) on resident corporates

Royalties, interest, and services paid to corporate resident recipients are subject to withholding taxes. In general, dividends paid to resident companies are not subject to withholding (except if the profits are distributed from “Benefitted Profits” that are subject to 15% withholding). In situations where approval has not been obtained from the ITA to withhold tax at a reduced rate, an exemption has not been granted, or the ITA has not approved the paying company’s bookkeeping system, the maximum payment withholding tax rate generally sits at 30%. These rates however, cannot be considered to be final as they may still be subject to a tax assessment.

Business in Israel

General information

Dividends

In general, resident companies already subject to corporate income tax are not charged tax on dividends. In principle, intercompany dividends are levied a tax at the level of the recipient company at the applicable corporate income tax rates. Dividends received by a resident company from a resident company are exempt if received from profits already subject to tax at the level of the distributing company. Profits not taxed at the distributing company level are taxed at a standard corporate income tax rate.

Withholding Tax (WHT) on non-resident corporates

In most cases, non-residents are also subject to withholding tax, including on dividends. Dividends paid to non-residents require withholding tax at a rate of 25% where the shareholding is below 10%, 30% where the shareholding is equal to or above 10%, and in the case where the payer is an Israeli resident company whose shares are listed and traded on a stock exchange at a rate of 25%. Reduced withholding tax rates of 4%/15%/20% may be applicable under certain special tax regimes. The withholding tax rate on interest to a non-resident company is generally the applicable corporate income tax rate at the time of payment (for example, 23% for a payment made in 2022). In the case of gross royalties paid by an Israeli company to a non-resident company, payments are subject to withholding tax at a rate of 23%. Other cases where a non-resident may be subject to withholding tax include bank transfers to non-resident corporate recipients when the transfer is classified as taxable income.

Capital gains

Resident companies' global income is taxable, and this includes capital gains. However, non-resident companies are solely taxable on capital gains related directly or indirectly to assets defined as Israeli. However, non-residents are generally exempt from capital gains tax for the sale of Israeli Companies' shares. These laws are subject to the provisions of an applicable income tax treaty. The taxable gain is computed by dividing the gain into real and inflationary components. The inflationary portion is generally tax exempt, while the tax rate is imposed on the real capital gains portion of the gain at a rate equal to the standard income tax rate of 23%.

Payroll tax

Payroll tax is not imposed in Israel, except for the charge levied on non-profit organizations and financial institutions. Non-profit organizations are charged a tax rate of 7.5% on wages that exceed NIS 193,972 a year. Financial institutions are subject to VAT on wages in addition to being taxed at a rate of 17%.

Government incentives

There are various investment incentives outlined in the Law for the Encouragement of Capital Investments, which was simplified and amended as recently as 2011 and is designed to encourage both local and foreign investors to invest in Israeli businesses. Other incentives include grant programmes for research and development, the employment of marginalised groups, and more. Businesses also receive incentives and tax breaks if they meet certain criteria. Companies that qualify as 'preferred enterprises' and promote their businesses in an area defined by the Law for the Encouragement of Capital Investment as Development Area A are subject to a lower income tax rate of 7.5%, whereas those operating outside said area are subject to tax at a rate of 16%. Special 'preferred enterprises' are taxed at an even lower rate of 5% when doing business within Area A. Preferred Technological Enterprises" are subject to a reduced tax rate of 7.5% if located in development Area A and to 12% in all other cases. Under specific conditions, large manufacturing companies may also be eligible for grants amounting to 20% of their investment in tangible fixed assets. The conditions for companies to qualify as 'preferred businesses' or 'special preferred businesses' are outlined in the Law for the Encouragement of Capital Investment. Other benefits such as accelerated depreciation lower the costs of assets and buildings used in the production of income for 'preferred enterprises' and 'special preferred enterprises.' These assets are entitled to accelerated depreciation. During the company's first five years of operation, its equipment depreciates at 200% of the ordinary rate of depreciation, and its buildings depreciate at a rate of 400% the usual rate, with a 20% ceiling of the building's value annually. Industrial companies are eligible for grants which can reach up to 20% (or even 30% in certain cases) of the amount of the original investment in fixed assets. To meet the conditions required to benefit from this grant, the company must be registered in Israel, located in a priority region, and contribute to Israel's international competitiveness (biotechnology and nanotechnology companies are exempt from this requirement).

Business in Israel

General information

Audit

In Israel all companies including locally registered branches are required to perform a financial statement and tax audit on an annual basis. The performance of an audit in Israel is based on generally accepted auditing standards, namely those prescribed by the Auditors' Regulations of 1973. The obligation to perform an audit is also included in the Israel Companies Law of 1999. Under these regulations, auditors are required to prepare and perform the audit to obtain reasonable assurance about whether the financial statements recorded, accounting principles used, and significant estimates made by the board of directors and managers are correct.

For auditors to certify an audit in Israel, they must have an Israeli accountancy certificate, which can be obtained by passing all the necessary examinations.

An entity is required to produce audited financial statements which include, at a minimum, a balance sheet, income statement and statement of changes in equity, and can also include a cash flow statement and notes to the financial statements including a tax reconciliation. The basis of the financial statements is that of Israeli GAAP, but IFRS is also acceptable.

The Israel tax year is aligned to the calendar year. Financial statements and tax returns are required to be submitted within five months of the fiscal year, although extensions may be obtained.

Labor & employment

The Israeli workforce is generally highly motivated, creative and dynamic. The combination of the rapidly growing technology sector as well as the highly skilled Israeli workforce results in a fast-moving employment market with a high demand for Israeli workers, by companies both within Israel and internationally.

In most situations, in order for a company to hire employees in Israel, an Israeli Permanent Establishment must be incorporated to be able set up a tax file to allow withholding of employee taxes. Israel has a progressive tax regime in that tax rates increase in line with remuneration. In addition, Israeli residents receive tax credits which are affected, amongst other factors, by gender status and number and age of children.

The current tax table for individuals as of 2023 is as follows:

Annual Income (NIS)	Monthly Income (Annual Income dividend by 12 - NIS)	Tax Rate
zero to 81,480	zero to 6,790	10%
81,481- 116,760	6,791- 9,730	14%
116,761- 187,440	9,731- 15,620	20%
187,441- 260,520	15,621- 21,710	31%
260,521- 542,160	21,711- 45,180	35%
542,161- 698,280	45,181- 58,190	47%
698,281 +	58,191 +	50%

Israeli employees enjoy a constantly evolving level of protection through a number of Labor Laws and regulations. This includes a minimum wage law which was enacted in 1987 and is updated from time to time with the most recent update in 2020. In addition, employees are entitled to a minimum of 12 days annual leave, along with Israeli national holidays. Sick days are also stipulated in Law and the Work and Rest Law limits the total number of hours that can be worked in a week and the requirement of payment for overtime hours.

Employers and employees are required to contribute to national insurance with rates varying depending on the salary amount. The National Insurance Scheme provides a range of benefits including maternity leave and statutory pension.

Both employers and employees are required to make social benefit contributions to cover pension obligations, and by employers to cover severance obligations. Many companies in Israel contribute towards "Study Funds" which comprise both an employer and employee contribution and although these are not obligatory, they are common, especially for skilled workers.

In order to dismiss an employee, a formal dismissal process must be triggered and employees are then entitled to a statutory notice period. An employee is entitled to receive a severance payment of their last

Business in Israel

General information

monthly salary multiplied by the number of years of employment on dismissal. Many employers elect to set-aside a contribution in line with Section 14 of the Severance Payment Law, in order to comply with the legal requirement whilst avoiding increasing liabilities in the form of severance accruals.

There are several types of Visas made available to foreign workers who wish to enter Israel. One such type of Visa is awarded to foreign “Experts”, if the company can evidence compliance with a number of requirements, including that the salary of the “Expert” is at least twice as high as the average salary in Israel at the time of employment.

Transfer Pricing

In June 2022 the transfer pricing bill in Israel passed its third reading. The new transfer pricing bill was thus approved. This is another step towards the Israel Tax Authorities (ITA) efforts to streamline the ITA’s supervision and control of transfer pricing relating to companies with operations in Israel.

The Israel Transfer Pricing regime is regulated by Section 85A of the Israel Income Tax Ordinance, which initially came into effect in November 2006. Guidance to the legislation was provided in several circulars including transfer pricing updates in: June 2020 (Circular 01/2020); November 2018 (Circular 15/2018); and September 2018 (Circular 11 and 12/2018).

The need for additional regulation was initiated as part of the provisions of Part 13 of the Base Erosion and Profit Shifting Program (BEPS), which is an OECD program to prevent tax avoidance by multinational enterprises (MNEs). Under BEPS Part 13, all MNEs with a group turnover exceeding EUR 350 million, are required to prepare a Country-by-Country Report (CbCR) with comprehensive data on the global allocation of income,

profit, taxes paid and economic activity among tax jurisdictions, in which it operates. This CbCR is shared with tax administrations in these jurisdictions for use in high level transfer pricing and BEPS risk assessments. Israel had initially committed to full compliance with these OECD regulations as early as 2016-2017, but has not yet managed to pass the legislation.

Currently transfer pricing is reported through ITA transfer pricing form 1385, which is included in the annual tax pack submitted by the Company reporting in Israel to the tax authorities. The tax form is submitted by corporate taxpayers and declares that the entity has engaged in cross-border transactions with related parties, and that these transactions have been conducted at arms-length. The form specifies the number of transactions, the transaction type, terms and conditions, parties to the transaction, transfer pricing method used, profitability rate, and whether or not the transactions are reported based on the new safe harbors detailed in Tax Circular 12/2018.

These forms currently enforce the company’s responsibility to keep up to date transfer pricing documentation, which includes, at a minimum, a transfer pricing study and an intercompany agreement.

The new regulation will apply to companies headquartered in Israel with global subsidiaries, as well as multinational companies headquartered outside of Israel, but with subsidiaries in Israel. The purpose is to oblige companies to provide the legislative required information to the Israel Tax Authorities (ITA) on an annual basis. This is to encourage transparency and to prevent tax evasion in the form of profit shifting. The updated reporting framework will also help the ITA to understand the division of profits throughout the global entity and, if necessary, to reallocate profits and, thereby, taxes to Israel.



Business in Israel

About Mazars

We are an international audit, tax and advisory firm committed to helping our clients confidently build and grow their businesses. We always seek to understand our clients and their environments, adjusting our recommendations and support accordingly.

Present in over 95 countries and territories, we work together as one team across borders and functions to deliver exceptional and tailored services. We combine our skills and expertise with both a global perspective and local knowledge to provide clients with a broad array of professional services in audit and accounting, as well as tax, financial advisory, and consulting services. We empower our people to help clients make the most of opportunities, operate with conviction, and give confidence to their stakeholders.

Mazars is a multicultural and united partnership with shared goals, values and service standards across the world. We take pride in our technical expertise and the quality of our work. We have the skills and the scale to serve clients of all sizes, across all sectors, while remaining agile, personal and distinct in our approach.

We approach every piece of work with integrity, independence, accountability and a social conscience, and we take responsibility for shaping a sustainable industry as well as helping build the economic foundations of a fair and prosperous world.

In Israel, Mazars has established itself as an independent challenger able to offer fluent and tailor-made solutions to large international groups and their subsidiaries. The complete, adaptable, and flexible range of services they offer makes them an ideal partner for companies of all sizes.

The company's Tel Aviv office includes an outsourcing and accounting department with specialized English, Hebrew, French, Spanish and Romanian-speaking professionals able to perform suitable accounting and administrative work for all their clients in their expansion, particularly within the framework of outsourcing engagement. A significant number of international corporations have chosen Mazars to supervise their accounting function, and Mazars look forward to helping you launch your company in Israel or assisting you to take your Israeli company global.



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Contacts

Steven Flax

Managing Partner – Accounting Outsourced Services
+972 73 768 5061
steven.flax@mazars.co.il

Gavriel Lebens

Partner – Israeli Outbound Expansion
+972 (0)3 613 5830
gavriel.lebens@mazars.co.il

Ivan Shapiro

Partner - Head of Assurance and Advisory
+972 73 768 5064
ivan.shapiro@mazars.co.il

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