Tax – Legal Update

New Double Tax Treaty between Israel and Germany

On May 10, 2016, the Income Tax Ordinance (Prevention of Double Taxation) (Germany) 5776-2016 was published in the Official Israeli Gazette. This Ordinance effectuates the new Agreement between Israel and Germany for Avoidance of Double Taxation, executed on August 21, 2014, and entering into effect as of January 1, 2017. This treaty replaces the previous one signed between Israel and Germany in the 1960s. The new treaty is based on the OECD Model Tax Convention and dramatically reduces tax withholding on passive income. Also, it includes provisions regarding exchange of information between the tax authorities of Israel and Germany, overriding the domestic statutes of each regarding bank secrecy.

A summary of the key provisions of the new treaty is provided below.

Dividends

Tax on dividend has been capped at 5% by the state of which the company paying the dividend is a resident where the company receiving the dividend holds at least 10% of the capital of the company paying the dividend. In all other cases, the tax rate has been set at 10%. These rates are dramatically reduced compared to 25% pursuant to the old treaty, but are contingent upon the condition that the recipient is the beneficial owner of the dividend.

Interest

Tax on interest by the state in which it arises has been capped at 5%, instead of 25% pursuant to the old treaty. Interest on corporate bonds traded on a stock exchange in one state and paid to a resident of the other state is exempt from tax in the first mentioned state as is interest on loans insured by a foreign trade risk insurance company owned by the government, and interest paid into a pension fund.

Capital Gains

In accordance with the principles of the OECD Model, capital gains on a share sale are exempt from tax in the state of residence of the company whose shares are being sold, unless more than 50% of the company's value derives from immovable property; in such case, the state in which the immovable property is located will have the right to tax. The treaty also stipulates "Exit Tax" provisions protecting the right of either state to impose tax on a person that was its resident and later became a resident of the other state.

Royalties

The treaty adopts the OECD Model principle whereby royalties are exempt from tax withholding in the state in which they arise.

Business Profits and Permanent Establishment

The profits of an enterprise will be taxable only in its state of residence unless the enterprise carries on business in the other state through a permanent establishment situated there, in which case the other state may tax the profit attributable to the permanent establishment. A "permanent establishment", in general terms, is a permanent place of business through which any or all of the business of the enterprise is conducted. For example, the location of the management, a branch or an office may constitute a permanent establishment. This definition also includes any building site or construction or installation project which lasts more than 12 months.

Exchange of Information

The treaty includes a specific article concerning exchange of information between the tax authorities reflecting the recent tendency of OECD states to enhance the collaboration between tax authorities and allow exchange of information about income generated within their boundaries by taxpayers of the other member states. Domestic bank secrecy laws will not prevent the authorities from exchanging information pursuant to the new treaty. The Protocol attached to the treaty states the notices that should be delivered to a person with respect to whom information is requested and the obligations on the receiving state with regard to safekeeping and documentation of the information received.

Pensions

Pensions paid to a resident of one state by a resident of the other state shall only be taxable in the first-mentioned state.

Shipping and Air Transportation

Profits from the operation of ships or aircraft in international traffic shall be taxable only in the state in which the place of effective management of the enterprise is situated.

Visiting Professors and Researchers

In order to encourage exchange of teachers and researchers, it has been agreed that a resident of one of the states who spends up to two years in the other state for the purpose of teaching, giving lectures or carrying out research at the university or as part of an official cultural exchange program will be exempt from tax in such other state.

Effective Date

The new treaty shall enter into effect on January 1, 2017.

For further information on these matters please contact Ofir Levy (ofirl@arnon.co.il) or Eran Lempert (lempert@arnon.co.il).