

**HOW TAX PLANNING BETWEEN ISRAEL AND THE UNITED STATES  
CAN SIGNIFICANTLY REDUCE YOUR TAXES**

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This article is the first of two that will provide an overview of U.S. and Israeli personal income tax and estate tax (taxes paid at the time of death). The article is intended for people who live, or plan to move to Israel, and to U.S. parents with children in Israel. It is also relevant for business people with activity in the U.S. who are neither U.S. citizens or green card holders

As a general rule, U.S. citizens and residents pay tax on their worldwide income. Thus the U.S. taxes of an Israeli citizen residing in the U.S. and a U.S. citizen living in Israel are basically the same. Both must file annual tax returns in the U.S. and report their worldwide income and foreign bank account.

On the other hand, non-citizens of the U.S. who are not residents of the US pay taxes only on income that is generated in the United States. The income that may be subject to Federal income tax fall into two categories: income that is tied to a business in the U.S., or "passive" income, such as interest, dividends, etc.

Obviously, for a non-citizen/non-resident with significant income outside the U.S., the question of when and whether that person will be considered a U.S. resident has very important tax implications. Most non-citizens may think that the term "resident" means what it does in the world of Immigration law. However, this is not the case. For tax purposes, a person who is either a citizen or green card holder indeed pays tax on world wide income. However, non-citizens without a green card will generally be considered residents if they meet the following criteria:

- a. Was in the U.S. 31 days during the year in question; and
- b. Was in the U.S. 183 days during the 3-year period, from the year in question and 2 years before that. However, in making the calculations, days present in the U.S. the year in question are counted as full days. Days present in the first year before that are counted as 1/3 days. Days present in the second year before that are counted as 1/6 days. So if the person was in the U.S. in 2009 the total of 93 days, and 120 days in 2008 and 120 days in 2007, the sum is 153 days. This person will not be considered a resident in 2009 for U.S. income tax purposes.

To summarize, if you have substantial income outside the U.S. and are neither a citizen or green card holder, you need to count your days carefully. Proper planning options are available.

On the other hand, if a significant part of your worldwide income is generated in the U.S., and you are a non-citizen, non-resident, then it may be preferable to be

considered a resident for tax purposes. Why? Because non-citizen non-residents pay a relatively high flat tax on the gross amount of income received and the amount of deductions they can claim to reduce their income is limited. Thus the income on which the flat tax is imposed is high.

With regard to Israeli taxation, Israel, like the United States, taxes its residents on a world-wide basis. Regardless of citizenship, an Israeli resident is taxed on income worldwide. Also like that U.S., Israel taxes non-residents only on income generated in Israel.

Does this mean that people end up being clobbered by taxes in both countries?

If this were the case, obviously few are the people that would move or invest abroad. Treaties to avoid double taxation solve this. The goal of the Treaty is to provide a tax credit in his/her country of residence for taxes paid in the other country. For example, a U.S. based taxpayer with \$50,000 taxable income in Israel would be taxed in Israel at 17.5%. The U.S. taxpayer would only be required to pay additional taxes in the U.S. if his/her tax rate on the \$50,000 is higher than 17.5%, in which case, the person would pay the I.R.S. only the difference. In the reverse case, the Israel-resident taxpayer is required to pay the 17.5% to the U.S., and then a Cap up to the marginal tax rate in Israel.

The most interesting scenario involves U.S citizens or residents who move or return to Israel. Under the above analysis, it would appear that this person pay Israeli taxes on worldwide income, and receive a credit for any income taxes paid in the U.S.

This is not the case, however, due to very special circumstances. First, Israel has granted substantial tax exemptions to Olim Hadashim and veteran ex-pats to attract them to move to Israel. The essence of these exemptions are that people moving or returning to Israel are exempt from taxation for a period of 10 years for all income that is generated **outside of Israel**. (Legislation providing investment benefits for this group is being finalized, and worth while exploring as well).

Given, however, that the person is a U.S. Citizen or resident, one would think that this income would still be taxed in the U.S. In some cases, this is the case. However significant loop-holes exist. With proper planning, the U.S. citizen with either an active U.S. business or passive income can move to Israel, and with proper planning, be exempt from taxes in the U.S. as well. This is true with regard to various types of investment income, capital gains, and most significantly, for salaries and several other related expenses paid to that person by a U.S. business, whether it is owned by that tax payer or not.

Will this income be taxed in Israel as Israel-sourced income? A complex question. Clearly, income generated in Israel is subject to Israeli tax. Yet proper planning can be highly effective. Clearly, the aim is to be fully exempt in both countries.

To summarize, the status of taxation between Israel and the U.S. is very fact specific, and depends on the status of each and every person and family. Non-U.S. taxpayers

who maintain some business activity in the U.S. should plan their U.S. actions carefully and count days. With regard to U.S. Citizens and residents living in Israel or planning to do so, and with regard to families of such people, there are significant areas where proper planning can be most beneficial. And for the person or family before or after the move to Israel, the importance of having a healthy monthly stream of income in U.S. Dollars to support live in Israel cannot be overestimated. Financial security is often a key factor in determining if and how a person will enjoy the life they hoped for in Israel. Proper planning can help and have a great beneficial for all parties involved.

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