CORPORATE TAX - ISRAEL

Zero-rate VAT on services to foreign residents – fact or fiction?

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The Value Added Tax (VAT) Law (5735-1976) sets out that zero-rate VAT applies to the export of services to a foreign resident. However, recent judgments have interpreted such relief in a narrow manner and have significantly reduced the ability to charge zero-rate VAT on services rendered to foreign residents.

General overview

VAT is levied in Israel pursuant to the VAT Law with respect to the consumption of goods and services in Israel. VAT is levied based on the added value at each stage of the sale.

The standard rate of VAT in Israel is currently 17%. However, certain transactions may be exempt from tax or subject to a zero-rate VAT. A zero-rated transaction means that no VAT applies to the services, but input VAT on related costs is recoverable.

Pursuant to a 2002 amendment to Section 30(a)(5) of the VAT Law and accompanying VAT Regulation 12(a), services rendered to a foreign resident are generally subject to a zero-rate VAT, except if the services concern an Israeli asset or the services are rendered to an Israeli resident in Israel in addition to the foreign resident.

Section 30(a)(5) states the following:

> *The rendering of a service to a foreign resident, other than a service designated by the Minister of Finance for this purpose; a service shall not be deemed to have been rendered to a foreign resident* ***if the subject matter of the agreement is the actual rendering of the service to an Israel resident in Israel, in addition to a foreign resident****.*

Prior to the amendment, zero-rate VAT applied to a service so long as the principal recipient of the service was a foreign resident. The 2002 amendment intended to exclude situations in which an Israeli resident is a secondary (even minor) service recipient from the zero-rate relief, in the hope of avoiding the need to establish the identity of the principal beneficiary of the services. Thus, the words "in addition to a foreign resident" were added to the section.

It appears from recent cases that the Israeli courts have extended their interpretation of the law to deny zero-rate relief even if an Israeli resident has received any kind of benefit from the services.

Recent court judgments

On 26 November 2019 the Tel Aviv-Yafo District Court issued a judgment in *Edmond de Rothschild Assets Management (Israel) Ltd v The Customs and VAT Division Tel Aviv*, finding that the services provided by the applicant (Rothschild Israel) to foreign entities in the Rothschild Group were liable to VAT at the standard rate.

Rothschild Israel provided marketing services to the Rothschild Group, including the marketing of funds managed by the Rothschild Group to Israeli investors. Even though Rothschild Israel did not directly engage with the Israeli investors, and the consideration for the services was paid solely by the Rothschild Group, the court found that Rothschild Israel provided services to Israeli investors by facilitating the investment in the Rothschild Group in various ways. Such services included:

- making the information regarding the Rothschild Group more accessible to Israeli investors;
- assisting Israeli investors with finding suitable investments within the Rothschild Group; and

- persuading Israeli investors to invest in the funds managed by the Rothschild Group.

In addition, according to the judgment, Rothschild Israel functioned as an address for Israeli investors for various enquiries regarding products offered by the Rothschild Group. The court also highlighted that the consideration received by Rothschild Israel was relatively high and accounted for fees paid by the Israeli investors to the Rothschild Group.

Another judgment was issued by the Merkaz-Lod District Court in *ISP Financial Management Ltd v VAT Petah Tikva* on 30 March 2020, ruling that marketing services provided by ISP Financial Management Ltd (ISP Israel) to a Swiss company within the ISP Group (ISP Switzerland) was subject to VAT at the standard rate.

ISP Israel provided marketing services to ISP Switzerland by marketing foreign funds represented by ISP Switzerland to Israeli financial institutions. The analysis of the court was similar to the analysis in the *Edmond de Rothschild* matter. The court concluded that ISP Israel did not function solely as a selling agent, but was additionally tasked with maintaining good relations between the Israeli financial institutions and the managers of the foreign funds. In addition, the court found that ISP Israel functioned as a representative of the foreign funds in Israel and as an address for the Israeli financial institutions. According to the court, in addition to making initial contact between the parties, ISP Israel assisted the Israeli financial institutions in communicating with the foreign funds' managers during the investment period.

Comment

Although the Israeli courts narrow the ability to receive zero-rate VAT relief with respect to services rendered to a foreign resident, the courts do mention cases in which the benefit of zero-rate VAT are not revoked, despite having an Israeli beneficiary. Such cases include, for example, marketing services provided to foreign entities aimed at a general population and not specifically to Israeli customers, and headhunting services where the services are provided to a recruiting foreign company without the provision of additional assistance to the Israeli candidates themselves in their search for employment.

It is also important to keep in mind that, according to Section 30(a)(5) of the VAT Law, the subject of the services will be examined in accordance with the agreement between the relevant parties.

The strict interpretation of the VAT Law by the courts emphasises the importance of designing the agreements and the engagements between an Israeli service provider and a foreign resident recipient in a way that allows for a zero-rate VAT.

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