משה שדה
הנהלת חשבונות
רח' ההסתדרות 10
ירושלים 94230
טל: 02-624-6057
פקס: 02-623-6105

Moshe Sadeh
Accountant
10 Hahistadrut St.
Jerusalem 94230
Tel: 02-624-6057
Fax: 02-623-6105

A Guide to Opening Up A New Business in Israel

Moshe Sadeh, Accountant

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Opening up a new business in Israel involves a lot of red tape. A new business in Israel has to immediately face dealing with three different governmental bodies (Value Added Tax, Bituach Leumi (which includes National Health Insurance) and the Income Tax Department).

A. **Value Added Tax** - (V.A.T.) (Mas Erech Musaf) (MA"AM) is collected on sales and services at the rate of 17%. The business must report and pay the V.A.T. collected to its local V.A.T. office on either a monthly or bi-monthly basis – depending on anticipated sales volume. The actual report and payment may be done at any Post Office branch using the payment voucher booklet received from the VAT Dept.
   a. **Step no 1. – Go to the V.A.T. office** with your Israeli I.D. (Teudat Zehut) number. There you will be given your authorized dealer number ("Osek Mursheh")
   b. **Step no. 2 – Go to a printer** and have invoices printed (Chesbonoit Mas). On the invoice you must print your authorized dealer number, your name, the address of your business and descriptions of services you render.

B. **Small Businesses** – A new small business opening up in 2021 whose total projected sales for the year is less than 99,893 shekels, can apply for a waiver of paying V.A.T. This status is known as "Osek Patur". If during the tax year your income exceeds 99,893 NIS you have to go to the V.A.T. and change your status to OSEK MURSHEH.

C. **Initial Investment Refund** – A new business may be able to get a refund on the V.A.T. it pays for the purchase of equipment and stock if they were bought through authorized V.A.T. dealers.

D. **Deducting 17% of Expenses Incurred** – If you become an authorized V.A.T. dealer you have the privilege of deducting the V.A.T. paid for business purchases and expenses against the V.A.T. collected, if they were done through an authorized dealer. It is important to know that expense deductions must be claimed within a six-month period.

E. **Bituach Leumi – National Insurance Institute (N.I.I.)** - All independent businessmen ("Atzmaim") in Israel are required to open a file and pay according to their projected income.
   a. If you had an income as an employee and income as self-employed by working less than 12 hours per week you will be charged N.I.I. on your self-employed income. However, if your earnings from self-employment are one shekel less than your salaried income (and on condition that these earnings are made by working less than 12 hours per week and are less than 25% of the average Israeli monthly salary, 10,551 X 25% = 2,638 shekels) you are not required to pay N.I.I.
   b. A married woman who works only as an independent less than 12 hours per week does not meet the definition as "Atzmai" and therefore can apply to be waived from paying N.I.I. on condition that her earnings are less than 25% of the average Israeli monthly salary (10,551 shekels – see above). However, if in addition she is also an employee and her salary is smaller than her self-employed income, she will be required to pay N.I.I. on her independent income and will be disallowed from receiving independent benefits, such as maternity and disability
   c. Self-employment by definition is one whose monthly gross income is at least 15% of average gross salary, which as of Jan. 2021 was 1,583 N.I.S. per month and 18,996 N.I.S. per year. If your only source of income is as an independent and even though

you work less than 12 hours per week, but exceed the above salary you will be required to pay N.I.I.

d. It is very important to keep your N.I.I. payments up to date because a considerable amount of your payment to N.I.I. is transferred to your Kupat Cholim so that you have medical and hospitalization coverage. **New business owners** should immediately open a file at N.I.I. in order to assure that they are getting medical and hospitalization coverage.

F. In addition, the N.I.I. covers other things such as reimbursing income lost while doing reserve army duty, reimbursing you on maternity leave and for work related accidents.

   a. N.I.I. is paid on an estimated income tax basis for new businesses. Each monthly payment is figured as following:
      i. 5.97% on income up to 6,331 shekels per month
      ii. 17.83% on income from 6,331 shekels up to a maximum of 44,020 shekels per month.
   b. N.I.I. yearly rates for independent businessman:
      i. 5.97% for the first 75,972 shekels
      ii. 17.83% for the income that is above 75,972 shekels up to 528,240 shekels
      iii. Men over 70 and woman over 65 pay at lower rates.
   c. Bituach Leumi (N.I.I.) payments must be made by the 15th of each month for the previous months income. Late payments will cause fines, linkage to the C.O.L. Index and loss of N.I.I. privileges and the privilege to be hospitalized with N.I.I. coverage. Amounts of payments can be altered during the year if there is an increase or decrease in business.

G. **Income Tax (Mas Hachnasa)** - According to the Israeli Income Tax Code you have to immediately open your income tax file upon opening your business. All new businesses are required to fill out form form 5329 – "individual details and sources of income".

H. If you know that you will be dealing with public organizations or contractors, you should request two important certifications:
   a. Ishur Nihul Sefarim – Authorization that you are keeping books according to the Israeli Tax Code regulations
   b. Ishur Nikui Mas BaMakor – Authorization of what rate of tax must be withheld at source by your customers.

I. Without receiving these two authorizations, many of your larger and institutional customers are prohibited from paying you unless they deduct from your bill a high rate of tax.

J. The Income Tax Department has bookkeeping regulations for each specific type of business. It's important to comply with these specific requirements in order for the tax department to give validity to your financial reporting and income tax return.

K. There are two main types of bookkeeping systems, which are recognized by the tax department. One is single entry bookkeeping, and the other is double entry bookkeeping.
   a. **Single Entry Bookkeeping** – most small businesses will fall into this classification.

      In many cases it's even possible for you to learn how to keep the books by yourself. You are required to record in an Income and Expense Book all transactions which the business has made with supporting documents. The book also has separate columns to record the V.A.T. you owe and the V.A.T. you can deduct on your monthly or bi-monthly payments.

      According to the type of business you may also have to keep an order book, list of accounts receivable, purchase invoice file, and list of inventory at the end of the year.
   b. **Double Entry Bookkeeping** – are required by all corporations and large businesses.

      This system includes a recording of all monies coming in and out of the bank, records of accounts payable and receivable, purchase inventory file, and list of inventory at the end of the year. In most cases, unless you have an accounting background and time available, a professional will have to be hired to do the job.

L. The Tax System works on a pay as you go system, whereby each business pays monthly or BI- monthly estimated tax payments – based on your net income as a percentage of your gross sales from your previous tax return. New businesses are given a percentage according to the profit rate figured out in their branch of enterprise.

M. Due to a change of profits a taxpayer can request to have his estimated tax payments lowered or raised. However, if at the end of the year the amended tax payments are too low the taxpayer will be penalized. If they are too high, he will receive a refund upon filing his yearly tax return.

N. **Employer's Responsibility** – if you employ workers or subcontractors you are required to open up an employers file at your local tax office. The Income Tax department will transfer this information to the N.I.I. who will open up a separate N.I.I. employers file for you.

   The Duty to Deduct Taxes – In the Israeli Income Tax Department Code Section No. 164 it is stated that everyone that pays or is in charge of paying income from work, needs to deduct at the time of payment income tax from the amount paid – according to the rates determined by the Israeli Income Tax Dept.

   Payments to lecturers and subcontractors (non-salaried individuals) come under the category of Miscellaneous Income and are exempt from Israeli National Insurance Tax, but are liable to Income Tax deductions. In addition to the personal taxes of the employee, the employer has other tax obligations according to Israeli Tax Law.

   a. **Israeli National Insurance Tax** – the employee pays 3.5% (3.1% N.H.I.+ 0.4% Old age and other National Insurance) on his salary up to 60% of the average Israeli Salary (as of Jan. 1, 2021 6,331 N.I.S.) and the employer pays 3.55% - total is 7.05%.

      On the salary above 60% of the average Israeli salary (up to 44,020 N.I.S. as of Jan. 1, 2021) the employee pays 12.00% (5.00% National Health Insurance +7.0% old age and other National Insurance) and the employer pays 7.60% - total is 19.60%.

   b. **The National Health Insurance Law** went into effect on Jan. 1, 1995. The employer is responsible to pay for his employees National Health Insurance according to their salaries. The employer must withhold 3.1% from the workers salary up to 60% of the average Israeli salary (as of Jan.1, 2021 6,331 N.I.S.) and 5.00% on the rest of his salary (up to 44,040 N.I.S. as of Jan 1, 2021).

   c. **Employer's Tax** – (Mas Masikim) has been cancelled .

   d. **Non Profit Organization Tax** – (Mas Sachar) All Non- Profit Organizations operating in Israel are required to pay a 7.5% tax on the gross salaries paid in the year 2021 are above 178,321 N.I.S. A Non- Profit organization with total salaries below this amount are waived from paying Mas Sachar.

   e. **Overseas Employers** – even though the payments of salaries are made overseas, the employer is still obligated to make Israeli tax payments for his workers employed in Israel.

   f. **Municipal Taxes** – Verify with your tax advisor which Municipal Taxes are applicable to you (Arnona, Business Tax, Business Permit and Sign Tax).

   g. **Capital Declaration (HATZERHAT HON)** The Income Tax Department generally requests that each new taxpayer declare his net worth. This has to be substantiated by bank statements, stock worth, loans etc. It is worth your while to keep records of all your documents on all capital transactions once you've opened a file, don't throw away anything. Keep records of all transfers of funds from abroad and all cashing of foreign currency, including gifts you receive. I advise all of my clients to do all of their transactions through a bank. It will be also worth your while to consult with a professional before filling this form out.

      The Capital Declaration includes the following:

      i. Net investment in business, partnerships, or corporation – including inventory, accounts receivable and payable, equipment, bank account balances and outstanding loans.

      ii. Personal Real Estate Assets.

iii. Private outstanding loans you gave – balance owed to you.
iv. Balance of all of your bank accounts.
v. Net investments in stocks, bonds, saving plans, life insurance, etc.
vi. Cost of your private vehicles.
vii. Lists of personal furniture, appliances, jewelry, art collections, etc.
viii. Personal Liabilities – mortgages, loans, etc.
ix. New additions to this statement in the last year are a declaration of what you have in a bank vault – and if and for whom you have power of attorney.
x. New Olim have up to 30 years to transfer their assets from abroad to Israel. I advise you to consult with your accountant if you have to declare these assets when filing the asset and liability statement if they haven't been transferred to Israel.
xi. The Capital Declaration is an extra check by the Tax Department to see if people are filing income tax honestly. This statement is compared with another one every four to five years. The information gathered is used by the Income Tax Authorities as a double check of the credibility of the tax returns and to see if the taxpayer has explanations for increases in capital. It is a good idea to give a full evaluation of capital, because this is the baseline that is used to check if you have been reporting your income fully.

O. **Tax Treaty – U.S. & Israel – Alert!** As of Jan. 1, 1995 a treaty will go into effect between the U.S. and Israel. This treaty will enable the two countries to exchange information on a limited basis. As far as the U.S. is concerned – Foreign Earned income is not taxable (up to $107,600), if you meet the Physical Presence Test. However taxpayers wishing to take advantage of these benefits have to file a timely tax return.

   If you are self-employed in a profession or business your earned income is tax free, if you meet one of the above tests. However if you earn more than $400 you are liable for social security payments which qualify you for all Social Security Benefits, such as Survivors, Disability and Retirement.

   As far as Israel is concerned – in most cases it recognizes taxes paid in the U.S. However, you should be aware that if you're in a high tax bracket in Israel, you may have to pay additional taxes on income earned abroad.

P. **Israeli Tax Reform** – The Israeli Tax System underwent a major revision as of Jan.1, 2003. The basis of determining whether an individual is liable to pay taxes in Israel has been changed from territorial to residential. The tax liability has been extended to include an individual's worldwide income as opposed to taxing him only on income earned in Israel. Credit will be given to the taxpayer on taxes paid abroad. Many sources of income which up to now have been waived from income tax in Israel may become taxable, such as capital gains on the Israeli, American or any other foreign stock market, interest on savings plans in Israel or abroad, dividends on worldwide investments, rent received from residential property in Israel or abroad and rent received on commercial property abroad.