



‘Subsidiary’ or ‘Branch’

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'Subsidiary' or 'Branch'

Many international companies, immediately before starting operations in Israel, face the dilemma of whether to set up a 'subsidiary' or open a 'branch' of the foreign company in Israel. In this discussion, we shall review in brief the considerations and differences that are relevant to this question, when making an informed decision as to whether to open a 'branch' or 'subsidiary' in Israel.

Legal liability (veil of incorporation)

A 'subsidiary' is a separate legal entity, whose shareholders are the foreign company. Therefore, the risk that the foreign company takes is limited to the amount of its investment in the subsidiary in Israel.

The above rule does not apply when operations are carried out between the subsidiary and the parent company that may cause the court in Israel to ignore the aforesaid separation and 'raise' the subsidiary's veil of incorporation, and in this way allow its creditors to take action against the foreign parent company.

The court in Israel does not tend to ignore the veil of incorporation as a matter of course and weighty reasons are required by the Companies Law in order for the court in Israel to raise the veil of incorporation.

In other words, from this viewpoint only, it is preferable to incorporate in Israel as a local 'subsidiary.'

A 'branch' is a business representation of the foreign company, by means of which the foreign company can operate and manage its business in Israel.

There may be situations in which the Israeli branch will merely constitute a 'marketing representation.'

In any case where the foreign company operates through a branch in Israel, the question whether those operations constitute a 'permanent establishment' will be examined.

A branch does not have a separate legal personality from its owner, even when its business operations are completely separate, such as a separate profit center.

Therefore, a foreign company operating in Israel through a branch may find itself being sued more easily from a legal viewpoint as a defendant for the

Legal liability (veil of incorporation) (Cont')

branch's debts (which derive from its operations in Israel). As a rule, the foreign company will be directly liable and responsible for all of the debts of the branch in Israel (to creditors / the tax authorities, etc.), for the simple reason that there is no legal separation – there is no veil of incorporation that separates them.

Bringing in a partner / sale of operations in Israel

Incorporating as a 'subsidiary' in Israel allows greater flexibility with regard to bringing in a (local or foreign) partner for those operations and/or in connection with the sale of operations in Israel (by way of a sale of shares in the Israeli company or by way of issuing shares of the subsidiary in Israel). It is important to note that, as a rule, the issue of shares does not constitute a tax event in Israel.

Tax considerations

An Israeli company is liable to pay tax in Israel on its profits, at a rate of 26.5% (for the year 2015), with the exception of companies that enjoy tax benefits pursuant to various stimulus laws, such as the Capital Investment Stimulus Law.

Moreover, in most cases additional tax will be paid on the distribution of the profits of the Israeli company as dividends, at a rate of up to 30% (the controlling owners that hold the company at a rate of 10% and higher), except when the dividends are distributed to an Israeli parent company (on certain conditions), or when we are speaking of a subsidized enterprise (pursuant to the Capital Investment Stimulus Law), or when the dividends are distributed to a parent company in a treaty country,¹ which grants a tax concession, pursuant to the relevant treaty (for example, pursuant to the tax treaty between Israel and France, the taxation of dividends will be 10% or 15% in certain conditions).

By contrast, an Israeli branch of a foreign company is liable for tax in Israel at the rate of companies tax only (i.e., 26.5% in 2015), without any additional tax liability for distribution of profits/dividends, since we are talking or a transfer from one pocket to another. The tax authorities regard the profits of the branch as belonging to the foreign company, the owner of the Israeli branch. According

¹ A state that signed a double taxation treaty with the State of Israel.

Tax considerations (Cont')

to the tax treaty, a company that pays tax in Israel for operations of the branch will enjoy a tax credit on the country of origin (check that this is correct – logic dictates that it is).

Appointment of a 'representative' for tax purposes

According to the local Value Added Tax Law, foreign residents that conduct business in Israel through foreign corporations have an obligation to appoint a representative. The representative may be an individual who is domiciled in Israel or a corporation registered in Israel.

The aforesaid law regulates the issue of registering a foreign dealer that operates in Israel and provides that a representative that is appointed by a foreign resident **is treated by the Value Added Tax Law as the taxpayer**. In other words, the representative has considerable liability for the operations of the foreign resident in Israel.

Moreover, a foreign resident that is required to appoint a representative pursuant to the Value Added Tax Law is also required to appoint a representative for the purposes of the Income Tax Ordinance.

The foreign resident's representative will be authorized to file reports to the tax authorities, to receive money for the foreign resident and to handle on his behalf any matter that is required by the law in Israel.

Keeping books in Israel

There is no difference between a 'branch' and a 'subsidiary' with regard to the manner of keeping books² and the obligation that applies with regard to the Income Tax Ordinance in Israel.

² The method of keeping accounts for the operations of the business in Israel is set out in the Income Tax (Keeping Books of Account) Instructions, 5733-1973.

Registration in Israel

Pursuant to the Companies Law in Israel, any foreign corporation that has business operations in Israel is liable to register with the Companies Registrar as a foreign corporation ('foreign company') that operates in Israel.

In addition, business operations in Israel require opening files and registering with the tax authorities in Israel (Value Added Tax, Income Tax, National Insurance and Income Tax (deductions)), even before starting such business operations.

An Israeli 'subsidiary,' from the moment of its incorporation and starting its operations in Israel, is also liable to register and open files as aforesaid with the tax authorities in Israel, in the same way as for operations through a 'branch.'

As a rule, setting up an Israeli company is a simple and quick procedure.

The registration of a 'branch' of a foreign company in Israel may be a little slower, but is also relatively simple and quick.

However, the process of opening a bank account in Israel for a 'branch' or 'subsidiary' of a foreign company that operates in Israel may be a little more complex than opening a bank account for a local Israeli company.

It should be emphasized that it is not possible to register and open files at the tax authorities before the company has opened a bank account in Israel, and therefore a 'subsidiary' or 'branch' that has not opened a bank account and registered with the tax authorities in Israel may not begin any business operations in Israel.

Business operations in Israel contrary to the aforesaid constitute a criminal offense.

In summary

From the viewpoint of tax considerations, it would appear that operations in Israel may be more worthwhile when operating in Israel through a 'branch' of a foreign company.

On the other hand, from the viewpoint of efficiency and legal protection considerations, it would appear that operations through the founding of a local Israeli company would be more correct.

Our firm's services include:

Representation of the foreign company before the tax authorities in Israel, such as Income Tax, Value Added Tax, National Insurance, etc.

- Obtaining tax arrangements before starting operations ('a pre-ruling'), obtaining tax benefits, etc.
- Supervision of the business operations of the foreign entity in Israel vis-à-vis various local parties, including business and strategic partners, suppliers, banks, financial institutions and the various State authorities.
- Assistance in choosing consultants where needed – attorneys, insurance agents, various suppliers, setting up IT systems, etc.
- Support in all operational and logistic matters.
- Providing accounting and auditing services and actually keeping the representation's books.
- Dealing with payroll and special salary arrangements.
- Business and economic services for the foreign corporation in its general dealings in Israel, carrying out various economic works (appraisals, due diligences, PPA, etc.), strategic planning and assistance in business development in Israel and abroad.

Nothing in the aforesaid should be regarded as a recommendation and/or opinion, and in all cases it is recommended that you obtain specific professional advice, in accordance with the concrete circumstances. We are at your disposal for any question and/or clarification in general or with regard to any specific matter.