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U.S. / ISRAELI INCOME TAX UPDATE FOR YEAR 2017 (2016 Tax Year)

The U.S. Presidential elections are behind us and the expectations are that many major tax and economic changes will be forthcoming from U.S. executive and legislative branches in the years to come. We will certainly keep you posted with updates on any major development. January, 2017 starts the beginning of the U.S. and Israeli 'tax season'. As such, it is imperative that you familiarize yourself with the many recent changes to existing tax rules and regulations which permeate both the U.S. Internal Revenue Code and Israeli Tax Ordinance, and contact your tax advisor accordingly.

FATCA/ FBAR: FATCA is an Intergovernmental Agreement (IGA) that the US Department of Justice has signed with 120 partner countries. The purpose of the IGA is to provide the US with knowledge about the financial income and balances of its citizens around the world. In essence, these agreements create a two way transfer of information between the foreign country and the US and from the US to the partner country. In effect the US could demand income tax returns from delinquent or non-filers based upon information received from a partner country, since the US taxes the world-wide income of its citizens. FATCA requires filing Form 8938 (see below for more details).

Exchange of Information between U.S. and Israel – Under the Inter-governmental Agreement (IGA) signed between Israel and the United States an exchange of tax information between the two countries was scheduled to begin during 2016. Israeli banks will be required to issue FORM 1099 to its customers who are U.S. citizens and also transmit these forms directly to the IRS. Reciprocally, in 2017, Israel should begin receiving U.S. tax information on its citizens directly from the U.S.

Revocation of U.S. Passports - The recent U.S. Highway Funding legislation calls for potential revocation or denial of U.S. passports for taxpayers with an outstanding balance of over \$50,000 to the IRS. Balances due to any State are not part of this legislation. The IRS must notify the taxpayer of this proceeding prior to facilitating a revocation of any U.S. passport. If payment arrangements have been made with the IRS, the taxpayer's passport would still be considered valid and will generally not be revoked.

PFICs (Passive Foreign Investment Companies) are reported on Form 8621 - Most investments in mutual funds registered outside the U.S. pose a potentially complicated tax issue for U.S. taxpayers. Whereas U.S. registered mutual funds report gains and losses annually to the IRS and to taxpayers, foreign mutual funds do not. The IRS has termed foreign mutual funds as PFICs. PFIC investments, when sold at a profit, have to report to the IRS the income subject to interest charges for each year that the investment was held. In effect the IRS wants to recoup the taxes that would have been paid had the PFIC reported its activity annually. As such, the Form 8621, (Information Return by a Shareholder of a PFIC or Qualified Electing Fund), must be filed with the taxpayer's Federal income tax return every year in which the taxpayer recognizes certain gains or distributions, or makes a taxation method "election" with respect to the fund. Adding to the complexity and volume of paperwork is that a separate Form 8621 must be filed for each PFIC (i.e. for each separate foreign mutual fund), whether or not there are current year sales. Most investors in PFICs must pay income tax on all distributions and appreciated share values regardless of whether capital gains tax rates would normally apply. Capital gains rates only apply to the current year portion of the gain. Prior year losses are generally not carried forward to offset current year gains. We recommend discussing this issue with your tax and investment advisor as there are alternative investments not subject to PFIC rules.

Form W-9

Israeli banks as well as some other financial institutions are now requiring customers to sign a U.S. form W-9 (or W8-BEN for non U.S. citizens) in order to open or continue banking or investing with your financial institution. In many cases, your Israeli bank may require a declaration that the last 3 years of U.S. income tax returns and FBARs have been duly filed. Not submitting the signed form can result in the bank freezing your Israeli account.

Israeli Tax Update

In light of the recent Israeli tax legislation and with the commencement of the 2016 tax year, many of our clients may require Israeli tax services during the year. To assist with overall tax planning and compliance, we have a network of tax professionals and lawyers that assist us in this capacity. Among the services provided are:

1. New or Current Businesses for self employed ("Atzmai"), Israeli corporations, and non-profit organizations ("Amutot"):
 - a) Assistance in opening files with V.A.T.
 - b) Opening files with Israeli Income Tax Authority ("Mas Hachnassah")
 - c) Opening files with National Insurance ("Bituach Leumi")
2. Filing Israeli income tax returns:
 - a) Individuals – including calculation of tax for self-employed individuals and filing for refunds based on charitable deductions. You may be eligible to receive a refund of up to 35% of charitable contributions against your Israeli tax paid if you contribute to recognized Israeli charities.
 - b) Corporations – all services including full bookkeeping, write-up, and audit
 - c) Non-profit organizations –including bookkeeping, write-up and audit
3. Representation before the Israeli Income Tax Authority, V.A.T., and Bituach Leumi in cases of audit, or correspondence received.
4. Projects to complete tax returns for delinquent or non-filers under the the Israeli Tax Amnesty Program.

Israel has also changed its tax regime for reporting foreign (non-Israeli) income from 2003 in addition to the regular tax on Israeli source income and has an amnesty program for taxpayers that have failed to report income earned abroad (e.g. from work or investment income earned in the U.S. or any other country). Proper tax planning and minimization of your taxes requires an analysis of many important issues, including the interplay between the non-Israeli and Israeli foreign U.S. income tax credit rules, the foreign earned income exclusion rules, and also how the applicable provisions of the U.S. – Israel income tax treaty (or with any other country that has an income tax treaty with Israel) affects your tax situation.

For your convenience herewith are the 2016 Israeli tax tables.

Tax Rate	Total income	Total taxes
10%	63,240	6,324
14%	108,000	12,590
21%	167,880	25,165
31%	239,760	47,448
34%	501,480	136,433
48%	999,999,999	

U.S. Child Tax Credit (recent changes)

Taxpayer identification number (SSN) is now required by due date of tax return. If you do not have a Social Security Number (SSN) for your dependent by the due date of your 2016 return (including extensions), you may not be able to claim the child tax credit ("CTC") or the additional child tax credit ("ACTC"). This applies to your original or amended 2016 tax return, even if you get the SSN at a later date. (i.e. A child born in March, 2016 has until December 15, 2017 to receive a Social Security Number and still be eligible to claim the credit.) Taxpayers who exclude earned income, currently up to \$101,300 (per taxpayer) on their 2016 joint tax returns will not be eligible to receive a child credit even if only one taxpayer uses the exclusion. **We recommend applying for Social Security numbers as soon as possible after your child is born.** Please be advised that the credit may not be able to be claimed retroactively. If you claim the CTC or ACTC, but you are not eligible for either credit and it is later determined that your error was due to reckless or intentional disregard of the CTC or ACTC rules, you will not be allowed to claim either credit for 2 years. If it is determined that your error was due to fraud, you will not be allowed to claim either credit for 10 years. You may also have to pay interest and penalties to the IRS.

IRS Streamlined Procedures for Non-Compliant U.S. Taxpayers Living Abroad and Offshore Voluntary Disclosure Program ("OVDI"):

In recognition that some U.S. citizens living abroad have failed to file annual U.S. Federal income tax returns and foreign bank account reports (FBARs), the IRS has designed a streamlined procedure to allow taxpayers to enter the IRS tax filing system and then be considered in "good standing". Many factors and requirements apply, but primarily this procedure is available for U.S. taxpayers that have resided outside the U.S. since January 1, 2009 and have not filed U.S. income tax returns for at least 3 years. Among the strict requirements for being accepted under the IRS streamlined process are: a) filing three years of U.S. income tax returns, b) filing six years of FBARs, c) not spending more than 35 days in U.S. in one of the last 3 years, d) writing a detailed explanation, delineating your non-willfulness and delinquency, and attaching it to your tax returns. The IRS will expedite the review process and may not assess penalties for taxpayers filing under this procedure. Taxpayers not meeting the requirements of the streamlined process can avail themselves of the IRS Offshore Voluntary Disclosure Program (please contact our office for more details about OVDI).

FBARs - Under the Bank Secrecy Act, a Foreign Bank Account Report (FBAR) must be e-filed annually with the U.S. Treasury by April 15th each year (which may be extended to December 15th if you have a valid extension for your current income tax return), if the following criteria apply:

- i) The person has a financial interest, signature authority or other authority that is comparable to a signature authority over one or more accounts in Israel or another foreign country. Please note that shareholders who hold more than 50% of a foreign company's shares are considered as having a financial interest in the company's accounts.
- ii) The aggregate value of all foreign financial accounts exceeds \$10,000 or the equivalent amount in foreign currency (e.g. 35,000 NIS or more) at any time during the calendar year.
- iii) Foreign financial accounts include, but are not limited to, both checking and savings accounts, Israeli pension accounts, brokerage accounts, mutual funds and unit trusts. Paper filings of FBARs (form TD F 90-22.1) are no longer accepted by the U.S. Treasury and have been replaced by online filing of form FINCEN 114.

Form 8938 (Statement of Foreign Financial Assets) must be filed with your U.S. income tax return (in addition to your FBARs), if you live in Israel (or abroad) and

- i) The value in your foreign financial accounts exceeds \$400,000 (filing joint) or \$200,000 (filing single) on the last day of the year, or
- ii) Your foreign financial accounts exceed \$600,000 (filing joint) or \$300,000 (filing single) at any time during the tax year.

The Affordable Care Act (aka "ObamaCare")

This law begins affecting taxpayers for 2014. Under the individual shared responsibility provision of the law, taxpayers must have minimum essential coverage (health insurance) for the entire year or will have to

make a shared responsibility payment ("SRP") on their 2016 tax returns. For most U.S. citizens living abroad there is an exemption from the SRP provided that the taxpayer would qualify under the bona fide residence or physical presence tests to exclude their income. Even if their income is not excluded, taxpayers residing abroad would generally qualify for the exemption from the SRP. U.S. citizens who meet neither the physical presence nor residency requirements will need to maintain minimum essential coverage, qualify for a coverage exemption or make a shared responsibility payment for each month of the year. For this purpose, minimum essential coverage includes a group health plan provided by an overseas employer. One exemption that may be particularly relevant to U.S. citizens living abroad for a small part of a year is the exemption for a short coverage gap. This exemption provides that no shared responsibility payment will be due for a once-per-year gap in coverage that lasts less than three months. Please be advised that the new U.S. administration is contemplating significant changes to this law. As such, we will keep you apprised of developments.

ITIN's for Non Resident Aliens – Individual tax identification numbers are required on every tax return submitted to the IRS. U.S. citizens must have a Social Security number that is used for all tax filings. A non-U.S. citizen with a U.S. tax filing requirement must obtain an ITIN before submitting his tax return to the Internal Revenue Service. Our office can assist you with the process of obtaining an ITIN if required, as there have been some new developments with the ITIN process.

ITIN's expire and have to be renewed. The IRS should generally notify you that your ITIN will be expiring and it will have to be renewed if you are still filing a current U.S. Income tax return. ITIN's that were not used to file a tax return at least once in the past 3 years will also expire. Expired ITIN's can be renewed through our office.

U.S. Income Tax Rates:

The U.S. income tax rates for the current tax year are 10%, 15%, 25%, 28%, 33%, 35% and 39.6%. Under the "stacking rule", in order to determine your income tax bracket, income excluded on Form 2555 (Foreign Earned Income Exclusion) will be added back to adjusted gross income. As a result, investment income may potentially be taxed at a higher tax bracket.

U.S. Foreign Earned Income Exclusion:

The foreign earned income exclusion has been adjusted for inflation and has increased to \$101,300 per taxpayer. As such, married taxpayers filing jointly, who meet certain requirements, may potentially exclude up to \$202,600 of foreign earned income per tax return. However, one spouse may not utilize the unused portion of the exclusion of the other spouse. If one taxpayer elects the exclusion on a joint return, starting for 2015 there will be no child credit available on that return. If you file separately, one spouse may claim the exclusion and one spouse may claim the child credit, which may result in a smaller refund than would have been on a joint return in a previous tax year (when it was permissible). Please note that the Foreign Earned Income Exclusion applies only to work or self-employment income and does NOT apply to other passive income such as pension benefits, investment income, rental or any other non-earned income.

Foreign Tax Credits:

A U.S. foreign tax credit may be used on non-U.S. taxes paid on income earned in a foreign country such as Israel. Conversely, Israel will also recognize taxes paid to the U.S. and apply them as a credit against your Israeli income tax liability.

Social Security Benefits Received by a U.S. Citizen Residing in Israel:

The U.S. - Israel Income Tax Treaty states that U.S. citizens that are Israeli residents are eligible to exclude U.S. Social Security benefits from their adjusted gross income. This provision may result in substantial tax savings. If you have included your social security income in the past on your income tax returns, our office can assist you with preparing your amended tax returns (up to three years retroactively) to potentially receive large refunds.

Long Term Capital Gains and Qualified Dividends:

Rates on long term capital gains (whether derived in the U.S., in Israel or in another country) generally apply to assets held for more than one year. For single taxpayers with taxable income under \$36,900 and for taxpayers filing jointly with taxable income under \$73,800 a zero percent long term capital gains and

qualified dividends rate will generally apply. Capital losses are still fully deductible against capital gains, and any capital losses in excess of capital gains may offset up to \$3,000 of ordinary income if married filing jointly. Net capital losses in excess of \$3,000 may be carried over indefinitely to future years.

Net Investment Taxes:

In addition to the “ObamaCare” tax rules, additional provisions of these rules are as follows: Beginning in 2013 the IRS has imposed an additional 3.8% tax on passive income for high income individuals (see table below). For this purpose, passive income includes interest, dividends and capital gains. Part of the passive income subject to this tax, are dividends from your foreign-owned corporation. The tax on this income cannot be taken as a credit for Israeli tax purposes. Therefore, it may be advisable that taxpayers with Israeli corporations report earnings as additional salary rather than declaring a dividend. Earnings from salary are not subject to this tax. Please contact our Israeli department for more details.

Filing Status	Income Threshold Amount
Married filing jointly	\$250,000
Married filing separately	\$125,000
Single	\$200,000
Head of household (with qualifying person)	\$200,000
Qualifying widow(er) with dependent child	\$250,000

U.S. Child Tax Credit:

If applicable, **\$1,000 per eligible child** may be available to offset any potential U.S. income tax liability or refunded. Taxpayers must have reportable earned income from wages (via Israeli Form 106 or similar foreign wage slip) or self-employment income in excess of \$3,000. The earned income of both husband and wife can be combined even if one spouse is NOT a U.S. citizen. The non-citizen spouse requires a U.S. tax identification number (TIN), which can be acquired by filing U.S. Tax Form W-7. Children must be U.S. citizens aged 16 and below and must possess a U.S. Social Security number. Please note that maximizing the child credit can be quite complicated since there are many factors to consider. In addition, the IRS has been conducting income tax audits which may require verification of income and other information. Amended tax returns may be filed back to the tax year 2013 in order to claim the child credit (2013 amended returns must generally be filed by April 15, 2017).

Estates and Gifts:

The gifting limit per spouse of \$14,000 annually to each eligible recipient includes children and grandchildren. Gifting continues to be an excellent way to potentially reduce the value of your U.S. taxable estate as well as future U.S. estate income taxes. There is an inflation adjusted exemption of \$5,340,000 on U.S. estates. Please consult your tax advisor for more details regarding your estate planning and writing a personal will. It should be noted that non US citizens investing directly in US real estate are only entitled to an Estate Tax Exclusion of \$60,000. Any property valued above that amount would have estate taxes assessed before the asset can be distributed.

State and Local Tax Returns:

Refunds may be available for taxpayers who may be unnecessarily filing resident U.S. State income tax returns after they moved to Israel. You should be aware that maintaining a bank account, brokerage account or driver’s license in a particular State does **not** automatically necessitate a tax filing in that particular State. However, if you own real estate, maintain a business, commute to and work in a particular State, or have any other activity considered nexus (strong connection) to a State, you would generally only file a **non-resident** income tax return in that State.

Standard Deduction:

Standard Deduction amounts are: Single or Married Filing separately - \$6,300; Married Filing Jointly - \$12,600; Head of Household - \$9,300. Taxpayers over the age of 65 may claim an additional deduction of \$1,200 each, if married, or \$1,550 if single. Taxpayers with qualifying deductions in excess of these amounts may generally itemize their deductions. Please note that bank mortgage interest, Israeli real estate tax (arnona), Israeli income taxes, and certain charitable contributions paid to Israeli sources may also qualify as itemized deductions. A phase out of itemized deductions will apply if income exceeds \$311,300 (filing joint) and \$259,400 (filing single).

Personal Exemptions:

A personal exemption of \$4,050 per person is available for each individual listed on the tax return for 2016. A U.S. citizen may only be claimed as an exemption once during each tax year. In some cases, grandparents may sometimes claim their grandchildren as exemptions on their income tax returns if they provided at least half the support of the grandchild **and** the grandchild lived with the grandparent.

Self-employment Income:

In order to qualify for future U.S. Social Security retirement benefits a taxpayer must pay in to the U.S. Social Security system a minimum of 40 quarters (credits). These credits can be earned even while residing in Israel. One can accrue a maximum of 4 quarters per year by earning in excess of \$5,500 annually. This is primarily accomplished by:

- i) Being self-employed in Israel and reporting Israeli self-employment income on your U.S. income tax return,
- ii) Working in Israel for a U.S. entity and receiving a Form W-2 (employee) or Form 1099 (independent contractor),
- iii) Traveling to the U.S. to work as an employee (W-2) or as a self-employed individual (1099).

Automatic Extension, Estimated Tax Payments and Automatic Withdrawal:

Automatic income tax return extensions are available until June 15, 2017 for U.S. taxpayers, who reside outside of the U.S. If there is a balance due with your tax return, interest will be accrued from April 15, 2017 while penalties will begin to accrue after June 15, 2017. Filing an extension will extend the time to file until October 15, 2017. An additional extension may be granted until December 15, 2017 but certain restrictions may apply. It is strongly recommended that taxpayers who owe income tax but do not file by June 15Th should make a payment with their extension. For the upcoming year, it is imperative that taxpayers pay estimated taxes on a timely basis in order to avoid underpayment of estimated tax penalties. Our office can assist you in setting up electronic payments with the IRS using the Electronic Federal Tax Payment System (EFTPS) via automatic withdrawal from your U.S. bank or other financial account.

Tax Retirement Plans/Required Minimum Distributions ("RMD"):

Within 60 days of a distribution from an Individual Retirement Plan ("IRA") a taxpayer can roll over the distribution to another retirement plan tax free. If no rollover is made within 60 days the taxpayer is required to pay tax on the distribution at ordinary income tax rates. Once you reach age 70 1/2 you generally must begin to withdraw funds from traditional IRAs on an annual basis and pay the required income tax. The amount of your RMD is calculated by using the IRS life expectancy tables. In addition, conversion to a Roth IRA can be a valuable tax planning tool for both U.S. and Israeli tax purposes. Your tax and pension advisor should be contacted in this regard.

Avoiding Early Withdrawal Penalties from Retirement Funds:

An early IRA distribution may be made without being subject to the 10% early withdrawal penalty provided the funds are used to purchase a first home even in Israel. The distribution amount is limited to \$10,000 per taxpayer and/or spouse from each individual's account. The early withdrawal penalty will also not apply in certain circumstances such as medical premium payments or higher educational expenses.

Higher Education Credit:

The American Opportunity credit ("AOC") can be claimed for qualified tuition and related expenses for any of the first four years of a college or university degree. The credit is up to \$2,500 for those paying \$4,000 or more in qualifying expenses for an eligible student. Forty percent of the credit is refundable which allows a taxpayer to receive up to \$1,000 cash back for each eligible student claimed on the tax return, even if no income tax is due. You cannot claim the credit and the tuition and fees deduction for the same student. The credit is generally available for U.S. universities and for certain foreign universities (please contact our office for the list of eligible Israeli universities). The credit begins to phase out at \$80,000 for taxpayers filing single or \$160,000 for taxpayers filing jointly. To claim the AOC a student must receive a Form 1098-T or equivalent that contains the Tax Identification Number of the university. We do not know at this time if all the accredited Israeli universities will be issuing Form 1098-T's.

Corporations, LLC's, Trusts and Form 5471:

Corporations may be excellent tax planning vehicles, especially for taxpayers working outside Israel and in light of Israeli tax reform. "C" Corporation tax rates are 15% on taxable income up to \$50,000, 25% from \$50,001 - \$75,000 and 34% from \$75,001 - \$100,000, with higher rates for higher taxable incomes. "S" Corporations, Limited Liability Companies ("LLC's") and certain Trusts are called pass-through entities. The pro-rata share of the pass-through entity's income must be reported on the taxpayer's personal income tax return and is taxed at the individual's personal income tax bracket. If you have a foreign corporation, you will be required to file form 5471 (Information Return of U.S. Persons with Respect to Certain Foreign Corporations) with your tax return (please contact our office for more details).

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