# Taxation of Expatriates

Germany • Israel

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## GERMANY

Germany imposes a so-called "extended limited liability tax " on German citizens who emigrate to a tax-haven country or do not assume residence in any country and who maintain substantial economic ties with Germany, as measured in terms of the individual's German source income or assets. The regime applies to both the German income tax and inheritance tax. This tax applies to an individual who was both a German citizen and a tax resident of Germany for at least five years during the 10-year period immediately prior to the cessation of his residence. The individual need not be a German citizen at time of emigration or at a later time. The qualifying individual is subject to the extended limited tax liability for 10 years after expatriation, except that no such tax is due in years when the individual has a German source income of no more than DM 32,000 ($16,000).[1] Under extended limited tax liability, the individual is taxed on all income that does not qualify as foreign income in the hands of a resident. This includes German source income that creates a tax liability for non-residents in general as well as German source income for which other non-residents are not liable to taxation, as well as income that is not German source income yet is not deemed to be foreign source income. Examples of such income are interest in German bank accounts or income from international consulting not attributable to a particular country, and passive income from foreign controlled companies. In the case of expatriation to countries with which Germany maintains treaties on the avoidance of double taxation, the tax treaties generally take precedence over the extended limited tax liability, [2] with the effect that any issues of double taxation are dealt with by treaty.[3] This German regime is similar to that currently imposed by section 877 of the U.S. Internal Revenue Code of 1986.

To avoid circumvention of the extended tax liability regime, Germany extends to expatriates who are subject to the extended limited tax liability the taxation of base company income from foreign controlled corporations that is imposed on German resident shareholders . This type of taxation is patterned after Subpart F of the U. S. Internal Revenue Code of 1954 as amended in 1962. Under the German rules, income from a foreign controlled corporation is attributed to a German resident taxpayer, if the taxpayer, alone or together with other residents, owns more than 50% of the voting shares of the controlled corporation, and if, in addition, the controlled corporation resides in a low tax country and the income is primarily passive income. In the case of expatriates under extended limited tax liability, German source income is attributed to the taxpayer if he owns over 50% of the controlled foreign corporation either alone or together with German residents.

Another tax liability is imposed on emigrating taxpayers who hold substantial ownership in a German corporation by taxing their change in residence as a deemed sale of the holding. A long-term (at least 10 year) resident of Germany, regardless of citizenship, who terminates his residence is deemed to have disposed of his ownership of a German corporation in which he owns more than 25%. This tax liability applies also if the taxpayer moves to a tax treaty country. However, this tax liability does not apply if the termination of

[1] Approximate exchange rate in March, 2000.

[2] Retain here, if desired, footnote referring to the discussion of double taxation.

[3] Reference to other parts of this publication, as in previous edition, if desired.

residence is temporary or does not exceed 5 years, or, with permission of the tax authorities, 10 years.

The gain from the deemed sale is determined according to the general rules governing the sale of domestic business enterprises, except that the fair market value at the time of relinquishing German residence is substituted for the sales price, and, if the taxpayer had already owned the corporate holding when coming to Germany, he may elect to substitute the fair market value of the holding at that time for the historical cost.

For the tax year 2000, the first 15 million DM of the gain (or imputed gain) from the sale of a substantial business holding are taxed at half the tax rate of ordinary income, and the remainder as ordinary business income. From the tax year 2001 on, such gains are taxed as ordinary business income, except for the potential reduction in the progressive tax rate resulting from the taxpayer's election to pro-rate the gain over the following five years.

These tax regimes for expatriates apparently were enacted in response to the expatriation of certain wealthy individuals, many of whom were highly visible to the general public as athletic or artistic performers. The Joint Committee staff was unable to find any information regarding the extent of any revenue raised by these provisions. Considering that the extended limited tax liability applies primarily to German source income, it should be enforceable by Germany. Enforcement also is enhanced by the taxation of foreign base company holdings.

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# ISRAEL

Income Tax is payable "upon the income of any person accruing in, derived from, or received in Israel..."[1]

An income received during a person's first seven years of residence in Israel "the source of which is outside Israel and which is chargeable with tax by reason only of its having been received in Israel" may be exempted from tax, or subject to a reduced tax (under 25%) upon decision of the Tax Commissioner.[2] The latter applies also to foreign corporations that transferred their business headquarters to Israel.[3]

In addition, an immigrant who sold foreign property within seven years following immigration is exempted from capital gain on this sale.[4]

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[1] Income Tax Ordinance (New Version)§2, as amended, 1 Laws of the State of Israel (New Version) 146 (1967).

[2] Id. §14, as amended.

[3] Y. Zilber, International Taxation, Law and Tax Planning in Israel 221 (1990).

[4] Supra note 1 §97(b), as amended.