Letter to the Self-Employed

Ministry of Finance

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With effect from 2017, and pursuant to Chapter B of the Economic Efficiency Law (Legislative Amendments for Implementing the Economic Plan for 2017-2018), 5777-2016 (hereinafter - "**the Law**"), self-employed persons (as they are defined in the Law) must make contributions towards a provident fund for a pension (hereinafter - "**the Pension Savings**"), at the rates prescribed in the Law.

To read the complete Law search "the Economic Efficiency Law"[1] on Google

Obligation to make contributions towards Pension Savings

The obligation to make contributions towards pension may be divided into two layers:

Layer 1 - up to one half of the average wage in the economy, the self-employed person will be obliged to make contributions of 4.45% towards a provident fund for a pension.

Layer 2 - above one half of the average wage in the economy and up to the amount of the average wage in the economy, the self-employed person will be obliged to make contributions of 12.55% towards a provident fund for a pension.

For part of the income* that is up to one half of the average wage**	For part of the income* that is above one half of the average wage and up to the average wage**
4.45%	12.55%

Below is a numerical example of the obligation to make contributions:

Monthly income*	For part of the income that is up to one half of the average wage** 4.5%	For part of the income that is above one half of the average wage and up to the average wage** 12.55%	**Total obligation to make contributions towards the Pension Savings**
5,000 NIS	215 NIS	21 NIS	**236 NIS**
7,000 NIS	215 NIS	272 NIS	**487 NIS**
10,000 NIS and above	215 NIS	607 NIS	**822 NIS**

[1] https://www.nevo.co.il/law_html/law01/501_527.htm

* Income liable for deposit pursuant to Section 2 of the Economic Efficiency Law (Legislative Amendments for Implementing the Economic Plan for 2017-2018), 5777-2016.
** The average wage in the economy as calculated for the purpose of pension and insurance payments pursuant to Section 2(b) of the National Insurance Law. As of 1.1.2017 it totals 9,673 NIS a month.

It should be emphasized that pursuant to the Law, the amount you are obliged to contribute is calculated annually, in accordance with your liable income during that tax year. The calculation set out above, which is presented in monthly terms, is an example solely for the purpose of illustration. An examination of the contribution according to the rates prescribed in the Law will be made in accordance with your income during the course of the year and according to the annual return which you submitted to the Israel Tax Authority for that year.

The pension contribution will be divided so that two thirds of the funds will be contributed towards **the pension element only** and one third (up to the ceiling prescribed in the Law) will be contributed towards **the assistance in a state of unemployment element** - a designated part of the Pension Savings which may be withdrawn in states of unemployment as they are defined in the Law (for example, closing the business in certain situations) and not only at retirement age. If you do not withdraw this element, you can use it to increase the pension after your retirement.

Pay attention

The obligation to make contributions towards the Pension Savings will not apply to the self-employed who are under 21 years of age, the self-employed who are over the early retirement age, within the meaning thereof in the Retirement Age Law, 5764-2004 (60 as of today), as well as the self-employed where 6 months have not yet passed from the date on which they were first registered as a trader pursuant to the Value Added Tax Law, 5736-1975. Furthermore, the obligation to make contributions will not apply to a self-employed person who was over 55 years of age before 1.1.2017. It should be clarified that the deposits to Pension Savings should be made for a particular year in the same tax year, and not in the following year. This is excluding exceptional cases which have been prescribed in the Law, and the restrictions and conditions prescribed in this matter.

Why are the Pension Savings important?

The Pension Savings are of supreme importance in determining your quality of life after you retire. For many employees, it constitutes the main source of income for the household during the retirement period. The earlier you make contributions towards the Pension Savings, the more the savings will grow and will allow you to maintain a higher standard of living over time.

The earlier you start to save, the more profits your money will be able to accumulate. The sum of money that you contribute during the first years of the saving will yield the most substantial part of the savings near retirement age. For example, 100,000 shekels at the age of 25 are anticipated to be worth more than 300,000 NIS upon retirement. However, 100,000 shekels at the age of 45 are anticipated to be worth less than 200,000 NIS at retirement age and 100,000 shekels at the age of 60 will be worth almost the same as their original value at retirement age.

Tax benefits for making contributions towards Pension Savings

Due to the importance of the Pension Savings, which constitutes the main source of income after retirement, the State grants tax benefits at the stage of the deposit, at the stage of the accumulation and at the stage of the withdrawal.

Pay attention - at the stage of the deposit, self-employed persons are entitled to tax benefits for deposits of up to 16% of their income (and in certain cases - 16.5%), up to the income ceiling prescribed in the Law. That is to say, in certain cases the tax benefits are also granted for making a contribution of a higher sum than that mandated in the Law. Therefore, it is possible that increasing the deposits beyond the minimum requirement will allow you to exhaust the tax benefits you are entitled to and reduce the tax liability. It is worthwhile examining the tax benefits which you are entitled to before making any contributions.

You can find information about the tax benefits on the Israel Tax Authority website in the "Know Your Rights" booklet[2].

It should be clarified that the tax benefits are granted in respect of the year in which the deposit was actually made.

Does making contributions towards pension include insurance cover?

This depends on the product you select for your pension savings:

- **Pension fund** - a pension fund includes built-in insurance in the event of loss of earning capacity (disability) or death (survivors), but savers who are unmarried and who do not have children may renounce the insurance in the event of death.
- **Managers' insurance** - in managers' insurance you can acquire insurance cover for death and loss of earning capacity if this is relevant for you. **Pay attention to the cost of the insurance cover!** There can be significant differences between the companies with regard to the costs of the insurance covers.
- **Savings provident fund** - for the most part does not include an insurance element, but savings only.

And what about management fees?

The company you have selected to manage the Pension Savings will charge management fees which constitute a considerable chunk of the savings over the years. Remember! You can always bargain over the management fees and reduce them. You can avail yourself of the management fees calculator of the Capital Market, Insurance and Savings Authority in order to compare between the management fees proposed by the various insurance, pension and provident fund companies: www.nihul.cma.gov.il

The Ministry of Finance and the Capital Market, Insurance and Savings Authority have a selection of pension funds which offer especially low management fees - you can also join these. You can find information about a selection of funds on the Capital Market, Insurance and Savings Authority website[3].

[2] https://taxes.gov.il/incometax/Pages/TaxesKnowYourRights.aspx
[3] https://mof.gov.il/hon/Pension/pension/Pages/DefaultFunds.aspx

Is a self-employed person who is also a salaried employee required to make contributions towards a provident fund for a pension?

For salaried employees, the employer is obliged to make contributions towards Pension Savings for the people he employs. If you are both self-employed and a salaried employee, and if the sum in respect of which contribution has been made for you as salaried employees to a pension provident fund, including the severance pay element, is higher than the amount you are required to contribute pursuant to the Pension for Self-Employed Law, you will not be required to also make contributions as self-employed persons. Otherwise, you should supplement the contribution as self-employed persons up to the ceiling required by the Law.

What should I do when I am unemployed (closing a business)?

When you make a deposit for the Pension Savings, one third of the annual deposit will be attributed to the savings in a state of unemployment element and this up to the ceiling prescribed in Section 9(7a)(a)(2) of the Income Tax Ordinance (approximately 12,200 NIS annually).

In order to be eligible to withdraw the assistance funds in a state of unemployment you should have made a deposit for at least 24 months of the past 36 months. Likewise, the Law allows you to withdraw these funds only in the following situations, and on condition that you do not have any income liable for deposit:

1. The self-employed person has ceased to practice his profession;
2. The self-employed person has closed his business;
3. The self-employed person has reached retirement age, and he has no other income liable for pension deposit.

If you comply with the conditions set out in detail in the Provident Fund Supervision Law and the regulations enacted thereunder, you can apply to the provident fund or to the insurance company where your savings are managed and withdraw the savings in a state of unemployment element.

Breach of the obligation to make contributions

The Law stipulates that failure to deposit all the payments that you are obliged to deposit in every tax year, with effect from the 2018 tax year and thereafter, is defined as an offense which is liable to lead to the imposition of a fine in the sum of 500 NIS for each tax year.

If you have not deposited the sums you are obliged to by law into the provident fund, you will receive a warning before the imposition of a fine on behalf of the Center for Collection of Fines, Fees and Expenses at the Law Enforcement and Collection System Authority. The warning will note the methods of filing confirmation of deposit which will enable you to avoid paying the fine, and contact details for the Center for Collection of Fines.

It should be clarified that the Law requires self-employed persons to make contributions towards Pension Savings with effect from January 2017. Nevertheless, the fine will only be imposed in respect of failure to make contributions with effect from the 2018 tax year and thereafter.

It is important to start saving as early as possible.

Therefore, self-employed persons who have not deposited the entire sum into a pension provident fund in accordance with what is stipulated in the statutory provisions in respect of the 2017 tax year, will also receive a personal notice on behalf of the Center for Collection of Fines, Fees and Expenses.

For the avoidance of doubt, in the event of any contradiction between the contents of this document and the contents of the Law or the regulations to be enacted thereunder, insofar as they are enacted, the provisions of the Law and the regulations thereunder, as published from time to time, shall prevail.

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Start saving for my pension – today!