

Democracy in Crisis: Shrinking Space for Civil Society in Israel

Bill to amend the Income Tax Ordinance
(Taxing a donation from a foreign state entity) 2023

I. The Essence of the Bill

The bill reads that a nonprofit organization that “interferes in the internal affairs of the State of Israel” and has received funding from a “foreign state entity” will no longer be considered a “Public Institution” as per the definition in the Income Tax Ordinance and as a “Not for Profit” as per the Value Added Tax Law. Moreover, a 65% tax will be levied on funds received from a foreign state entity.

“A donation that interferes in the internal affairs of the State of Israel” is defined as a donation to organizations engaged in a variety of advocacy activities and in promoting policy vis-à-vis state authorities and Israel’s public opinion.¹

“A foreign state entity” is defined in section 36a of the Associations Law and essentially comprises a state, a union of states, or a municipality in a foreign country, including their organs, or their representatives, or corporations owned by them, as well as the Palestinian Authority.²

The bill reads that a donation from a mediating agent will be considered as funding from a foreign state entity if the receiving side knew or could have known that this funding was influenced by financial support from a foreign state entity.

II. Implications for Nonprofit Organizations

1. Canceling the tax exemption for the organization’s income (according to section 9(2) of the Income Tax Ordinance).
2. Canceling the option of holding an approval according to section 46(a) of the Income Tax Ordinance, which provides the possibility of an income tax credit for donors to the nonprofit organization.
3. Canceling the possibility of receiving an exemption from capital gains tax according to section 97(a)(4) of the Income Tax Ordinance for donating capital assets.
4. Levying an expanded tax rate of 65% on income from funds allocated by a foreign state entity.
5. Canceling the organization’s “Not for Profit” status (according to the VAT law).³



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The implications detailed above - each one separately and all of them together - are detrimental to the status of a nonprofit organization as such, by denying it the tax benefits that nonprofit organizations enjoy. In practice, they could lead to the closure and elimination of organizations or to actual harm to their funding, greatly limiting their activity. It is important to emphasize that the implications of the bill will apply to the organization in general, even if the funding from a foreign state entity serves as a modest part of its financial resources.

III. Characteristics of the Nonprofit Organizations Potentially Affected by the Bill

According to the 2018 NPI's Yearbook, 152 nonprofits received funding from a foreign state entity in 2018, amounting to 489 million NIS.

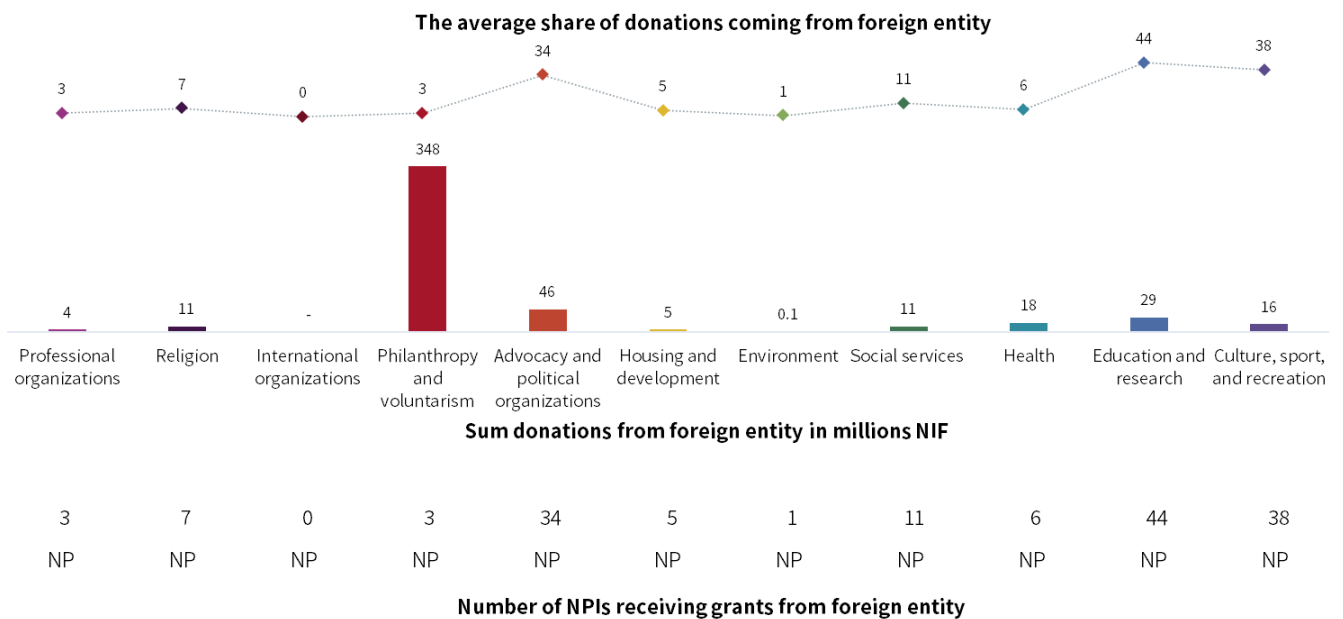
The greater part of this funding was allocated to the Foundation for the Welfare of Holocaust Victims - 346 million NIS - which make up 71% of the total sum granted by foreign state entities (a consistent finding since 2012).

However, the majority of nonprofits reporting on funding from a foreign state entity are concentrated in the fields of education and research, culture, sports and recreation and advocacy (44, 38, and 34 respectively) (Figure 1).

The objectives of the nonprofits receiving foreign state entity funding are many and varied. They include human rights advocacy, promoting equality, promoting women in sports, orchestras, museums, reducing violence against women, reducing violence in schools, English teaching in schools, developing sustainable agriculture, commemorating soldiers in world wars, and more.

- Funding from a foreign state entity is most frequent in the field of advocacy: 12% of the nonprofits in this field received support from a foreign state entity in comparison to at most 8% of the nonprofit organizations in all other fields.
- For 11 nonprofits, funding from a foreign state entity comprised at least 90% of their income.
- For 71 nonprofits, funding from a foreign state entity comprised less than 10% of their income.
- For 34 nonprofits in the field of advocacy, foreign state entity funding comprised 41% of their income, on average.

Figure 1: Funding from foreign state entity in 2018 by field of activity⁴



In addition to the nonprofits presented here (and included in the NPIs Yearbook), funding to Israel's research universities must also be taken into account.

Researchers at universities receive many research grants from foreign state entities. These include grants from the European Union (for example, through the Horizon 2020 Program, researchers in Israeli universities received a total sum of about 700 million euros); grants from bi-national research funds, such as BSF (for collaborative research between Israeli and American scientists), which awards Israeli researchers about 10 million dollars a year; and GIF (for collaborative projects between German and Israeli scientists) which awards grants approximately of 12 million euro a year to Israeli researchers. These research grants are valuable to the promotion of scientific research in Israel.

IV. International Comparison

[The Global Philanthropy Environment Index 2022](#)⁵ draws comparisons and assigns scores to various aspects of the "philanthropic environment" in various countries, particularly to the policy they adopt toward philanthropy. Israel's score on its policy regarding "cross-border flows" is 3.50 (on a 1-5 scale), similar to the average global score of 3.51. This score, however, relates to receiving and giving donations combined. In the component of *receiving* donations from abroad, Israel scored lower (3.00) due to the reporting requirement already incumbent on funding from a foreign state entity. The bill, if approved, is expected to place Israel even below anti-liberal countries such as Hungary, Poland, and Russia, and at the level of dictatorships such as China and others in Central and South America, the Middle East, and Africa.

Other countries that place limitations on donations from foreign sources do not tend to draw distinctions between types of foreign donors (individuals, corporations, foundations and state entities). By comparison to other developed countries, Israel is unique in that 60% of the donations to nonprofit organizations are allocated from foreign donors (about 10 billion NIS a year), most prominent among them Jewish communities in the world. Seemingly, then, to avoid harming these resources, Israel endorses a policy that places limitations only on funding from a foreign state entity.

V. Summary and Conclusions

Israel's civil society organizations are largely supported by donations from abroad (from individuals, corporations, foundations and state entities). The bill thus specifically targets civil society organizations that receive funding from a foreign state entity, distinguishing them from many other civil society organizations that also receive donations from abroad - from individuals, corporations and foundations.

If an expansive approach to the definition of "interference in the internal affairs of the State of Israel" is implemented, the law may apply to the vast majority of organizations that receive funding from a foreign state entity, for all the diverse purposes they promote, excluding them all from the "Public Institution" and "Not for Profit" status.

At the same time, insofar as the decision on whether the activities of a nonprofit organization "interfere in the internal affairs of the State of Israel" is left to the discretion of a government official, this bill enables further politicization of the supervision of civil society organizations in general.

Beyond the fact that the Israeli regime rests on the division of powers, civil society organizations are extremely important and allow voice and expression to society's many nuances: multiple and diverse needs, beliefs, cultural preferences, ideological positions, and perspectives. Challenging social conventions, shedding light on blind spots, and advocating against government policies from a civic perspective is inherent to the role of nonprofit organization within civil society. Civil society, therefore, is a pluralistic social fabric meant to complete and balance the democratic mechanism of majority rule.

Politicizing the supervision of civil society organizations and grinding them down economically, as proposed in this bill, contradicts the principle of civil society's independence. **The above data point to the increased risk confronting advocacy organizations, which frequently challenge the government and its policy.**

Attention should be drawn to the opposite perception that acknowledges the problematic nature of such a politicized process - only recently the Knesset preliminary passed a bill reading to reduce the politicization of the process of granting approval for tax credits according to section 46(a) of the Income Tax Ordinance.



Notes

¹ The rationale reads: "...interference in legal issues in Israel, in the political activity, in the government's policy, in the municipal policy or in the broad public opinion."

² The "Law on the duty of disclosure for recipients of support from a foreign state entity" compels ongoing reporting on such funding.

³ Although the implications are not specified, it could mean that the nonprofit will be required to pay VAT on its income, including grants and donations.

⁴ The findings presented here are analyzed based on the raw data, and published in the 2018 NPIs Yearbook. Note that they do not reflect full reporting of all the active nonprofit organizations. These data may be updated with the expected publication of the 2020 NPI yearbook.

The fields of activity are presented according to the international classification—ICNPO. For additional information, see the 2018 NPI Yearbook, p. 10. Activities classified to Advocacy include the protection of civil and other rights, promotion of social or general political interests, promotion of the interests of specific groups, and provision of legal services. The Foundation for the Welfare of Holocaust Victims mentioned above is classified to Philanthropy and Volunteering. The activities under this category include mainly philanthropic foundations and promotion of voluntary endeavors.

⁵ The Global Philanthropy Environment Index is an international report led by the School of Philanthropy at Indiana University with the participation of 100 experts from the world. The Index measures and evaluates the environment for philanthropic activity in 91 countries and economies by examining the incentives and barriers to giving, while shedding light on the complex system of regulations, politics, and cultures that shape global philanthropy. The updated index reviews the 2018-2020 period.



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