Narrative Report on Israel

PART 1: NARRATIVE REPORT

Telling the story

In 2003, influenced by a global trend to combat hidden bank accounts and tax haven entities, Israel shifted its tax system to a new tax base - imposing income tax on a worldwide basis. As part of this shift, Israel also introduced *"Controlled Foreign Corporation (CFC) rules, worldwide Vocational Taxation provisions, extensive reporting requirements and a revolutionary trust law reform, all of which intend to significantly increase tax collection while combating tax evasion"*[1].

Three years later, on January 1, 2006, Israel amended the Income Tax Ordinance [new version], 5721-1961 (hereinafter: "Income Tax Ordinance") to include a list of tax planning schemes which must be reported to the tax authority[2]. The list became effective as of January 1, 2007 and was updated with additional tax planning schemes in 2016 and 2017.[3] In addition, in 2016 new reporting requirements were introduced when certain tax opinions are received by tax payers, e.g. opinions in which the adviser's fee depends on the tax savings which are derived from receiving the opinion; opinions which are considered "off-the-shelf opinions"; and opinions which hold a position contradicting that of the tax authorities.

However, and contrary to this trend to 'clamp down' on tax dodging, in September 2008 Israel amended its Income Tax Ordinance (Amendment No.168) and granted tax exemptions for "New Immigrants" (persons who have never held an Israeli residency) and for "Veteran Returning Residents" (Israeli citizens who have spent abroad at least ten consecutive years as foreign residents). To a certain extent, this amendment has turned Israel into a 'limited tax haven' for many Jewish individuals[4]. As a result, new immigrants and veteran returning residents are exempt from Israeli income tax and reporting obligations regarding their non-Israeli source income and gains (as well as from filing tax returns and capital declarations) for a ten-year period commencing of the year in which they became Israeli New/Veteran residents (sections 134B and 135 of the Income Tax Ordinance). In practice, the amendment "*provides (high) net wealth individuals with a unique opportunity to transfer funds from off-shore jurisdictions and financial centers into Israel, while enjoying the 'protection' of a respectable country, which is not classified as a low tax jurisdiction*"[5]. Moreover, in 2009 Israel even amended the law to provide the Head of the Israeli Tax Authorities (ITA) a discretion to extend the exemption from such filing obligations for an additional ten-year period (up to 20 years altogether) to individual new immigrants/veteran returning residents who will make substantial investment in Israel within two years of their arrival in Israel.

A consequence of the ITA's reporting exemptions has been the limitations the ITA placed upon itself in being able to access financial and identity information regarding new immigrants and returning veterans. A clear restriction exists, for example, regarding trusts. As the OECD's Global Forum on Transparency and Exchange of Information for Tax Purposes (hereinafter: "the Global Forum") reports in 2016[6] (p.33): "*Israeli law does not ensure the availability of identity information in respect of the settlors, trustees and beneficiaries of foreign resident trusts having a trustee resident in Israel and for trusts created by new immigrants and veteran returning residents which are vested with assets or income from*

Rank: 34

Chart 1 - How Secretive?

63
Secrecy Score

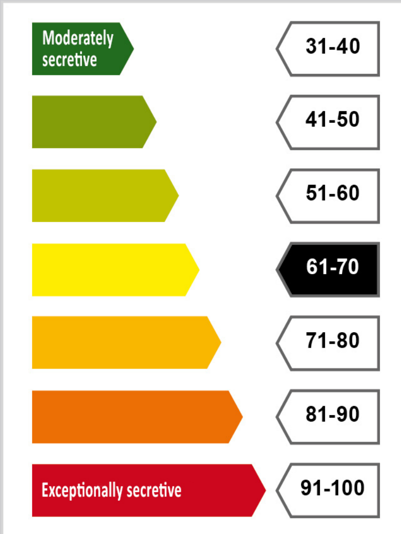
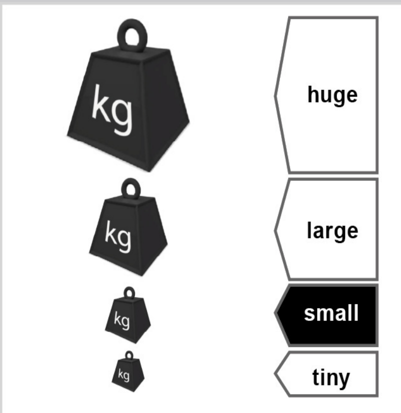


Chart 2 - How Big?



Israel accounts for less than 1 per cent of the global market for offshore financial services, making it a small player compared with other secrecy juridic-tions.

The ranking is based on a combination of its secrecy score and scale weighting.

Full data on Israel is available here: http://www.financialsecrecyindex.com/database.

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assets abroad for a period of 10 years if the trust is operated by a resident trustee who is not an attorney or an accountant covered by AML obligations."

Due to pressure from international organisations[7] (p.54), since 2013 a bill to repeal the reporting exemption, while leaving the tax exemption as is, has been included almost every year in the Israeli Economic Arrangements Bill. Nonetheless, as of December 2017, the legislative proposal was not approved.[8]

These exemptions have serious implications also regarding money laundering. As the US States Department emphasised for several years in its International Narcotics Control Strategy Report (INCSR) reports: "*Israel's 'right of return' citizenship laws mean that criminal figures find it easy to obtain an Israeli passport without meeting long residence requirements. It is not uncommon for criminal figures suspected of money laundering to hold passports in a home country, a third country for business, and Israel*"[9].

In its 2016 INCSR report, the US States Department further added[10] (p.146): "*Criminal groups in Israel, either home-grown or with ties to the former Soviet Union, United States, or EU, often utilize a maze of offshore shell companies and bearer shares to obscure ownership*".[11]

Indeed, Israel has a large shadow economy. In 2010, the World Bank estimated the black economy as equal to almost 23 percent of Israel's GDP in 2007[12]. This estimate was confirmed in 2014 by the Taub Center[13] for Social Policy Studies in Israel. According to research carried out by Visa Europe in 2013, the black economy is equal to NIS 185 billion (approximately US$ 51.2 billion) a year[14]. The ITA estimate that tax evasion is the underlying motive for about 80 percent of this black economy[15]. One of the reasons for such a high figure is that in practice, due to several exemptions provided in the Income Tax Ordinance for filing tax returns, and because neither gifts nor inheritances are taxed, most Israeli residents are not required to file income tax returns[16].

In light of these estimates, in February 2012, the ITA declared a 'war on tax evasion'[17] and submitted to the Minister of Finance "recommendations for the struggle against black capital and tighter enforcement, with the goal of tripling the ministry's promise of higher tax collection". The recommendations included making tax evasion a predicate offence for Anti Money Laundering. Other recommendations "include halving cash transactions from NIS 20,000 to NIS 10,000, and levying a 15% fine on exceeding the limit; legislation to allow sending information to the Tax Authority from the Currency Services Registrar and for the Tax Authority to become the regulator of foreign exchange traders; amending family firm regulations to close tax loopholes; delaying foreign travel by people with tax arrears; permit offsets by taxpayers to prevent hiding assets between spouses; impose guarantees on court-ordered payments; foreclosures on taxes of local authorities and religious councils; and levy taxes on guarantors."[18]

As a result of these recommendations, on 31st July 2013 Israel enacted[19] a law requiring money changers and currency service providers to report any transactions involving sums in excess of NIS 50,000 to the tax authority. The law requires the establishment of a database comprised of this information, which the tax authority can use to locate tax evaders through market exchange service providers. Additional amendments[20] (p.225) were made in 2014, including subjecting lawyers and accountants to customer due diligence (CDD) requirements as well as obliging money service businesses to implement CDD requirements. In an effort to ensure legislative alignment, in April 2016 the Prohibition on Money Laundering Law was amended to include serious tax offences as predicate offences and to allow a direct transfer of information between the Israel Money Laundering and Terror Financing Prohibition Authority (IMPA) and the ITA. [21]

Alongside these amendments, in February 2016, The Financial Action Task Force (FATF) on money laundering announced that Israel would join the organisation as an observer starting June 2016.[22] One of the amendments required by the FATF for Israel to become a full member was imposing limitations of the usage of cash and the cross-border transportation of currency (recommendation n. 32[23] of the FATF). The bill for the reduction of the use of cash was indeed approved in a first reading in July 2015. It aims to limit the use of cash to NIS 10,000 for businesses and NIS 50,000 for individuals. In January 2018, following long delays and strong resistance from the Jewish religious community, the plan to reduce the usage of can was approved as part of the 2018 Israeli Arrangements Law.

There have also been several developments in respect of exchange of information for tax purposes. On 30th June 2014 Israel signed[24] an inter-governmental agreement with the United States to implement FATCA provisions (according to Model I IGA which provides for reciprocity between the two partners).In addition, on 27 October 2014 Israel declared its intention to join the OECD's Common Reporting Standard (CRS) by end of 2018 and to make the necessary legislation amendments for it.[25] An amendment[26] (p.16) to the Income Tax Ordinance came into force on 1 January 2016 which enables Israel to conclude international agreements solely for exchange of information. Following this amendment, in June 2017, Israel has signed the Multilateral Competent Authority Agreement.[27]

Regarding tax incentives policy, for many years Israel provided tax incentives for the encouragement of foreign investments. Prior to 2011, the Investment Law for Encouragement of Capital Investment, 5719-1959 ("the Investment Law") gave preferential treatment to foreign investments in Israel. Companies that invested a substantial amount of money in Israel, as determined by law, were granted zero corporate tax rates for ten years. However, Amendment 68[28] to the Investment Law, in force as of 2011, abolished this preferential treatment and eliminated the exemption from corporate income tax granted to corporations.

In addition, in 2015 the government enacted a law to increase the Tax Benefits for Individuals Investing in R&D Companies Law ("Angels' Law").[29] As explained by the IBFD, "Amendments to the 2010 "Angels' Law" will modify tax incentives provided for new investments in Israeli start-ups in order to make the law more effective in terms of raising capital. Specifically, investors will be able to deduct, for income tax purposes, 100% of their investment during the first year (currently, a deduction over three years is possible provided the company maintains a start-up status)[30]."

Finally, in 2016, Israel approved law amendments that introduce patent box regime for intellectual property (IP) of based companies. The amendments include a reduced corporate income tax rate of 6% on IP-based income and on capital gains from future sale of IP. The 6% rate would apply to qualifying Israeli companies that are part of a group with global consolidated revenue of over ILS10 billion (US$2.5 billion). It appears that the new regime "was tailored by the Israeli Government to a post-base erosion and profit shifting (BEPS) world, encouraging multinationals to consolidate IP ownership and profits in Israel along with existing Israeli research and development (R&D) functions".[31]

Source: Moran Harari, TJN IL

Endnotes:

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PART 2: ISRAEL'S SECRECY SCORE

OWNERSHIP REGISTRATION

- 56% — 1. Banking Secrecy
- 50% — 2. Trust and Foundations Register
- 100% — 3. Recorded Company Ownership
- 50% — 4. Other Wealth Ownership
- 100% — 5. Limited Partnership Transparency

LEGAL ENTITY TRANSPARENCY

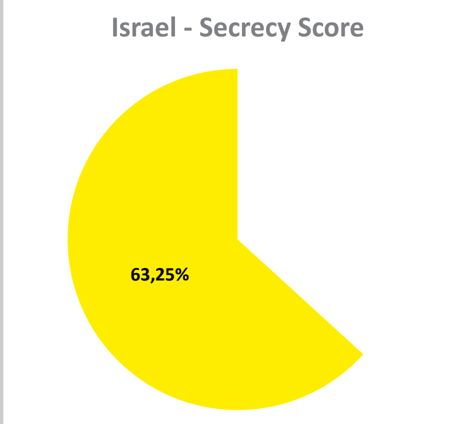
- 100% — 6. Public Company Ownership
- 100% — 7. Public Company Accounts
- 100% — 8. Country-by-Country Reporting
- 75% — 9. Corporate Tax Disclosure
- 100% — 10. Legal Entity Identifier

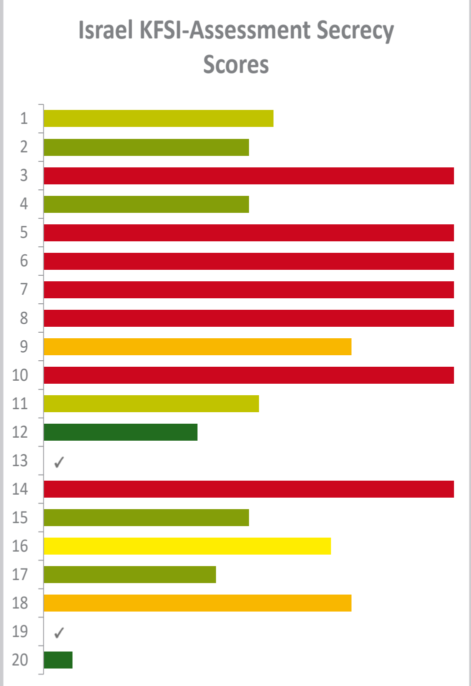
INTEGRITY OF TAX AND FINANCIAL REGULATION

- 53% — 11. Tax Administration Capacity
- 38% — 12. Consistent Personal Income Tax
- 0% — 13. Avoids Promoting Tax Evasion
- 100% — 14. Tax Court Secrecy
- 50% — 15. Harmful Structures
- 70% — 16. Public Statistics

INTERNATIONAL STANDARDS AND COOPERATION

- 42% — 17. Anti-Money Laundering
- 75% — 18. Automatic Information Exchange
- 0% — 19. Bilateral Treaties
- 7% — 20. International Legal Cooperation





Notes and Sources

The ranking is based on a combination of its secrecy score and scale weighting (click here to see our full methodology).

The secrecy score of 51 per cent has been computed as the average score of 20 Key Financial Secrecy Indicators (KFSI), listed on the left. Each KFSI is explained in more detail by clicking on the name of the indicator.

A grey tick indicates full compliance with the relevant indicator, meaning least secrecy; red indicates non-compliance (most secrecy); colours in between partial compliance.

This paper draws on data sources including regulatory reports, legislation, regulation and news available as of 30.09.2017.

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