

# EXCHANGE OF INFORMATION: ISRAEL INCHES TOWARD INTERNATIONAL NORMS

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## Tags

Exchange of Information  
Israel  
O.E.C.D. Convention

## INTRODUCTION

The State of Israel has always invested a large amount of effort to attract people from around the world to immigrate to Israel and to invest their funds in Israel.

As part of these efforts, Section 14 of the Israeli Income Tax Ordinance stipulates that when a person becomes a new Israeli resident, Israel grants the individual a ten-year exemption from disclosing to the Israeli tax authorities any information regarding non-Israeli assets, sources of income, and capital gains. This tax holiday also applies to senior returning residents who resume Israeli residency after residing overseas for at least ten years.

Some global tax policy officials claim that Israel has blindly accepted the source of funds that were invested in Israel by new immigrants and that it disregarded the possibility that the investments were made with the proceeds of tax evasion in other countries. For this reason, it is claimed that Israel has not been eager to disclose information regarding these funds and assets to other states.

## PERSPECTIVE

The lack of willingness to disclose fiscal information between states has been a standard practice among nations, as evidenced in early multilateral conventions. One of the first conventions to deal with legal assistance between countries was the European Convention on Mutual Assistance in Criminal Matters 1959 (the “Strasbourg Convention”).<sup>1</sup> The Strasbourg Convention specifically stipulated in Article 2 that any legal assistance may be refused in regard to fiscal offences.

Israel has adopted and ratified the Strasbourg Convention. However, in parallel to this convention, Israel, like many other states, has signed numerous double taxation treaties that call for exchange of information (“E.O.I.”) regarding tax matters. In most double taxation treaties, the E.O.I. clause allows each Member State the sovereignty to decide whether or not it wishes to disclose information. Israel generally has preferred to maintain its sovereignty rather than willingly promote E.O.I. regarding assets and income located in Israel.

## RECENT DEVELOPMENTS

Recently, Israel has reversed its prior position and has moved to establish an active E.O.I. policy. This is partly due to Israel’s desire to obtain information regarding

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<sup>1</sup> European Convention on Mutual Assistance in Criminal Matters, CETS No.030, Strasbourg, April 20, 1959.

financial activities of Israeli residents abroad and partly due to the worldwide trend toward breaking all secrecy barriers between tax authorities and financial institutions. As a result, effective January 2016, Israel has instituted new laws that will enable it to join international conventions and treaties relating to the disclosure and exchange of information regarding income and assets in Israel. Consequently, Israel will provide financial information to other foreign tax authorities. In turn, Israel will receive financial information relating to its residents.

The new laws enable Israel to join the Multilateral Convention on Mutual Administrative Assistance in Tax Matters (the “M.L.A.T. Convention”).<sup>2</sup> As we will show, joining the O.E.C.D. Convention does not necessarily mean that Israel will in fact abandon its historical position of preferring sovereignty over disclosure.

### **Israel Joins the M.L.A.T. Convention**

As mentioned above, on November 24, 2015, Israel joined the M.L.A.T. Convention, making it the 91st jurisdiction to join.<sup>3</sup>

The M.L.A.T. Convention obligates the Member States to exchange information with each other concerning income and assets of residents of the Member States. The information can be used by the receiving state only for income tax purposes. Information is made available on a reciprocal basis between each of two states under existing Tax Information Exchange Agreements.

The M.L.A.T. Convention applies to a wide range of taxes, including taxes on income; capital gains; net wealth; compulsory social security; estates, inheritances, or gifts; immovable property; and consumption, such as value added tax (“V.A.T.”), or sales; etc.<sup>4</sup>

The Israeli State Revenue Administration in the Ministry of Finance has stated that Israel will enforce the M.L.A.T. Convention on direct taxes only, not including social security payments.<sup>5</sup> This means that the Israeli law regarding E.O.I. will not be imposed on indirect taxes, especially V.A.T. Another interesting question is with regard to real estate tax. Israel may claim, that real estate tax is not covered by the M.L.A.T. Convention. This means that Israel may decide not to transfer information regarding the purchase and sale of real estate in Israel. Furthermore, Israel will not enforce the M.L.A.T. Convention’s provisions on assistance in tax examinations abroad or on tax collection and service of documents, a decision which will not be addressed in this article.

Under the M.L.A.T. Convention there are five methods of exchanging information: E.O.I. on request, automatic exchange of information (“A.E.O.I.”), spontaneous E.O.I., simultaneous tax examinations, and tax examinations abroad. Each Mem



<sup>2</sup> O.E.C.D. and Council of Europe, *Multilateral Convention on Mutual Administrative Assistance in Tax Matters: Amended by the 2010 Protocol*, (Paris: O.E.C.D. Publishing, 2011), last modified February 2016 (the “O.E.C.D. Convention”).

<sup>3</sup> O.E.C.D., “Israel Joins International Efforts to Boost Transparency and End Tax Evasion,” news release, Nov. 24, 2015; Ministry of Finance, “Israel Signed the Multilateral Convention on Mutual Administrative Assistance in Tax Matters,” news release, Nov. 25, 2015.

<sup>4</sup> *O.E.C.D. Convention*, art. 2.

<sup>5</sup> “Israel Signed the Multilateral Convention.”

ber State can decide at its sole discretion whether or not to transfer information to other Member States by using one or more of these methods.

### E.O.I. on Request

Upon the request of a Member State (the “Applicant State”), the Member State receiving the request (the “Requested State”) must provide the Applicant State with any relevant information that concerns particular taxpayers or transactions. In order to comply with the request for information, the Requested State must provide information available in its tax files. It must also take all relevant measures to provide the Applicant State with the information requested.<sup>6</sup>

### A.E.O.I.

The M.L.A.T. Convention does not specify the way to conduct A.E.O.I., and in this respect, the O.E.C.D. published the Standard for Automatic Exchange of Financial Account Information in Tax Matters (the “Standard”) on July 21, 2014.<sup>7</sup>

The Standard calls for Member States to obtain information from domestic financial institutions and automatically exchange that information with other Member States on an annual basis. The Standard also determines the type of financial information to be reported and exchanged, the different types of accounts and taxpayers covered, and the common due diligence procedures to be followed by domestic financial institutions.

According to the Standard, financial institutions (e.g., banks and insurance companies) will determine a process for identifying account owners that are residents of foreign countries. The financial institutions will then collect information with respect to such account holders and transfer that information to the relevant tax authorities in the other Member State. This information will include balances and financial revenues of foreign account holders.<sup>8</sup>

Given the importance of implementing A.E.O.I., competent authorities from over 79 jurisdictions have signed the Common Reporting Standard Multilateral Competent Authority Agreement (the “C.R.S. M.C.A.A.”), which implements the Standard and specifies the details of what information will be exchanged and when. While the C.R.S. M.C.A.A. is multilateral, the actual A.E.O.I. will be implemented bilaterally.<sup>9</sup>

Israel has yet to join the C.R.S. M.C.A.A. However, on October 27, 2014, the Israeli Ministry of Finance notified the O.E.C.D. that it will adopt the procedure for the automatic exchange of financial account information for tax purposes (referred to as the “Common Reporting Standard” or the “C.R.S.”) by the end of 2018. The procedure will be implemented via an agreement between the relevant authorities in countries complying with the procedure.<sup>10</sup>

<sup>6</sup> O.E.C.D. Convention, art. 5.

<sup>7</sup> *Id.*, art. 6; O.E.C.D., *Standard for Automatic Exchange of Financial Account Information in Tax Matters*, (Paris: O.E.C.D. Publishing, July 21, 2014) (“*The Standard*”).

<sup>8</sup> *The Standard*.

<sup>9</sup> O.E.C.D. Convention; O.E.C.D., “[The CRS Multilateral Competent Authority Agreement \(MCAA\)](#).”

<sup>10</sup> Ministry of Finance, “[Israel to Adopt OECD Procedure for the Automatic Exchange of Financial Account Information](#),” news release, Oct. 27, 2015.

**“Under the M.L.A.T. Convention there are five methods of exchanging information:**

**E.O.I. on request, A.E.O.I., spontaneous E.O.I., simultaneous tax examinations, and tax examinations abroad.”**

### Spontaneous E.O.I.

A party can spontaneously forward information to another party in the following circumstances:<sup>11</sup>

- A party concludes that there may be a loss of tax in the other party jurisdiction.
- A taxpayer obtains a reduction or exemption from tax in a party jurisdiction, which may result in an increase in tax or liability to tax in the other party jurisdiction.
- Business dealings between two taxpayers from different party jurisdictions are conducted through one or more countries in a way that may result in tax savings in one of the party jurisdictions, or in both.
- A party concludes that tax savings may result from artificial transfers of profits within a group of enterprises.
- Information forwarded to a party by the other party may be relevant in assessing the tax liability in the latter party jurisdiction.

### Simultaneous Tax Examinations

Two or more parties shall consult with each other and determine cases and procedures for simultaneous tax examinations. During these examinations, two or more parties are each conducting domestic investigations into the tax affairs of a taxpayer or taxpayers in which they have common or related interest. The purpose of these examinations is that each state will exchange any relevant information it obtains during the examinations.<sup>12</sup>

### Tax Examinations Abroad

The competent authority of the Applicant State can request to be present in tax examinations conducted by the competent authority of the Requested State. The Requested State can refuse to include the Applicant State in its examination, and even if it decides to allow the request, all decisions with respect to the conduct of the tax examination shall only be made by the Requested State.<sup>13</sup>

### **Israel Amends Tax Laws Regarding E.O.I. with Certain Reservations**

On November 19, 2015, a week before joining the M.L.A.T. Convention, the Israeli parliament, the Knesset, approved a bill to increase enforcement of the M.L.A.T. Convention against tax evaders (the “Bill”).<sup>14</sup> As of January 1, 2016, the Bill enables the director of Israeli Tax Authority (the “I.T.A.”) to transfer information to a foreign country according to an international treaty for enforcement under the tax laws of that country.<sup>15</sup>

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<sup>11</sup> *O.E.C.D. Convention*, art. 7.

<sup>12</sup> *Id.*, art. 8.

<sup>13</sup> *Id.*, art. 9.

<sup>14</sup> The Law of Amending the Income Tax Ordinance (No. 207) - 2015.

<sup>15</sup> Ministry of Finance, “The State of Israel Increases Enforcement Ability Against Tax Evaders.” news release, Nov. 22, 2015.

***“The Bill stipulates additional conditions that allow Israel to disregard provisions of the M.L.A.T. Convention. These additional conditions give precedence to the sovereignty of the I.T.A.”***

The main goal of the Bill was to enable Israel to join the M.L.A.T. Convention. However, the Bill stipulates additional conditions that allow Israel to disregard provisions of the M.L.A.T. Convention. These additional conditions give precedence to the sovereignty of the I.T.A. (which may decide whether or not to transfer information) over the promotion of E.O.I. with other Member States.

According to the Bill, the director of the I.T.A. (the “Director”) may transfer information to a “Foreign Tax Authority” according to an international agreement, subject to the following conditions:

1. If the information is transferred at the initiative of the Director, it should be verified that the requested information is needed for the enforcement of the domestic tax law of the foreign Member State.<sup>16</sup>
2. If the information is transferred at the request of the Foreign Tax Authority, the Director should be convinced that the foreign requesting country requires the requested information in order to enforce its domestic tax law.<sup>17</sup>
3. The I.T.A. is allowed to use the requested information in order to enforce its domestic tax law.<sup>18</sup>
4. The foreign country is committed to the confidentiality and safekeeping of the requested information, as determined by an international agreement.
5. The Foreign Tax Authority uses the information solely for the purpose of enforcement of its domestic tax law.
6. The Foreign Tax Authority will transfer the information to other institutions in the foreign country solely for the purpose of enforcing its domestic tax law.
7. The Foreign Tax Authority will not transfer the information to other countries.<sup>19</sup>
8. The I.T.A. is allowed (under current Israeli tax law) to decide to withhold information from a country that does not keep up with international standards of E.O.I.
9. The I.T.A. will notify an Israeli resident, in the case of a request for information, at least 14 days before transferring the information, unless the requesting country has asked for secrecy.
10. No information will be transferred to a Foreign Tax Authority according to an international agreement if such transfer of information could harm Israel’s national security, public safety, pending investigations, public policy, or any other matters that are vital to the State of Israel.<sup>20</sup>

<sup>16</sup> It remains to be seen how Israel will interpret this provision.

<sup>17</sup> This provision may also be widely interpreted by Israel and may result in the refusal of an information disclosure to another country.

<sup>18</sup> “Tax law” is defined as a law that deals with the imposition of tax or with a mandatory payment that it is the responsibility of the Finance Minister to execute.

<sup>19</sup> It is interesting to see that sections 5, 6, and 7 only apply to Foreign Tax Authorities and the I.T.A. is not subject to these provisions at all.

<sup>20</sup> This provision may also be widely interpreted and may lead to the refusal to transfer information to other countries.

## CONCLUSION

Today, even after Israel has amended its domestic law and joined the M.L.A.T. Convention, Israel's intention seems to remain the same – to obtain information with respect to its residents but not to allow for disclosure of any information to other countries where such disclosure fails to meet protective provisions under Israeli domestic law. It seems that both the new law and the provisions of the M.L.A.T. Convention do not damage the sovereignty of Israel to deny any disclosure of information.

There is no question that as long as Israel does not amend the provisions of the tax holiday given to new immigrants and senior returning residents, these individuals will be allowed to deny the I.T.A. any information regarding their foreign assets and income, and Israel will thus be unable to disclose information it does not possess.

The one exception that may have a crucial effect on the balance between sovereignty and disclosure relating to Israeli-based assets and income is the A.E.O.I. procedure, under which a Member State truly loses its ability to decide what information is disclosed to other Foreign Tax Authorities. Israel has not established a plan to implement A.E.O.I. procedures and so far has not changed its laws in this respect. According to the current Israeli law, the I.T.A. is not entitled to receive any kind of information from Israeli banks and such information can only be obtained from individual taxpayers or by a court order in connection with an on-going criminal investigation. However, it is expected that Israel will adopt A.E.O.I. procedures by the end of 2018.

Although A.E.O.I. has yet to be implemented in Israeli law, this procedure has definitely changed the way Israeli banks operate – and did so long before Israel even joined the M.L.A.T. Convention. Today, all domestic Israeli banks require that information regarding the tax residency of the account owner must be provided at the time of account opening. In addition, each account owner must sign a waiver in order to protect the bank in the event it discloses information relating to the account to the I.T.A. or to any Foreign Tax Authority.

The interesting question remains whether Israel will truly agree to relinquish its sovereignty and its historical objective of promoting immigration from around the world and allowing immigrants to bring funds with them under assurance of confidentiality.

