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Cancellation of Israel's Reporting Exemption for New Immigrants and Expansion of Reporting Obligations

Client Updates

On February 21, 2024, a draft of a new bill, for the amendment of the Israeli Income Tax Ordinance, was published for the public's comments.

The proposed legislative amendment is intended to implement recommendations published in 2022 by The Global Forum on Transparency and Exchange of Information for Tax, operating as part of the OECD, which indicated that Israel's reporting obligations do not comply with international standards. The criticism included in the report gave rise to concern that if Israel does not see to meet the Global Forum's recommendations, it could be placed on the "blacklist" of insufficient compliance regimes, which could potentially lead to the imposition of economic sanctions, higher withholding tax rates, and stricter regulation on money transfers to Israel. To rectify the deficiencies pointed out by the Global Forum, the recently published bill seeks to amend certain provisions of the Income Tax Ordinance, revoke provisions granting reporting exemptions, and add reporting obligations.

Abolishing Reporting Exemption for New and Veteran Returning Israeli Tax Residents

Since 2007, new Israeli tax residents and veteran returning tax residents (individuals who returned to Israel after being foreign tax residents for at least ten years prior to their return) are entitled to tax and reporting exemptions with respect to their foreign assets and income earned outside of Israel, for a period of 10 years commencing on the date they became Israeli tax residents. Over the years, attempts have been made to abolish the reporting exemption, alleging that it does not meet international reporting standards and facilitates tax evasion. The current proposed legislation seeks, once again, to revoke the reporting exemption so that these tax residents will have to report their worldwide assets and income. It is important to emphasize that the bill only intends to apply reporting obligations, not to revoke the tax exemption.

The legislative amendment would also enable the Tax Authority to require foreign entities that are effectively managed by a new or veteran returning Israeli tax residents to report in Israel, and to maintain accounting records according to Israeli standards (although they are not considered Israeli-resident companies).

Cancellation of the aforesaid reporting exemption will also affect trusts, as the current reporting exemption also applies to the establishment of trusts by and contribution of foreign assets to trusts by such

individuals. In other words, a settlor and under certain circumstances also the trustee, will be required to report on the trust's establishment and the contribution of assets to the trust.

It should be noted, that the bill does not change the acclimation year provisions. Therefore, in practice, the use of the acclimation year that allows new and veteran returning tax residents to choose to be considered as foreign residents for their first residential year - would allow such individuals not to report their income and assets in the first year of residency.

Beneficial Ownership Reporting Obligations and Expanding Trusts Reporting

One of the main recommendations of the Global Forum regards beneficial ownership information. Accordingly, the bill stipulates that entities' annual tax returns would include details of their "controlling individuals" and their tax residency.

A "controlling individual" is an individual who has the ability to direct the entity's activities, alone, together, or through others. In addition, one would be considered a "controlling individual" if he holds 25% of the controlling interests in the entity, as long as there is no one with a larger share. If no individual meets one of the above-mentioned criteria, the chairman of the board of directors, CEO, or an equivalent position with effective control over the entity will be considered a "controlling individual" for the sake of the required reporting.

The reporting obligation is intended to also apply to trusts, while the settlor, the trustee, the protector, or the beneficiary of the trust, would be considered as a "controlling individual", whereas if one of them is a corporation - the controlling individual of that corporation will be considered a "controlling individual" for the purpose of the report. The bill goes even further, requiring an Israeli trustee to report the existence of the trust and its "controlling individuals" and their tax residency, even if the trust is not required to submit tax returns in Israel (namely, if except for the trustee's residency it has no nexus to Israel).

Entry into Force of the Legislative Amendment

The bill is solely a proposed legislation amendment that is still open to the public's comments. Once the amendment is legislated, the reporting obligation for new and veteran returning Israeli tax residents will only apply to those who became Israeli residents starting from June 1, 2025, and onward. The reporting obligation for "controlling individuals" will apply to the tax return for the year 2024 (to be filed in 2025). Trusts that are not required to file an annual tax return in Israel and existed prior to the legislation of the amendment will be required to submit information on their "controlling individuals" and their tax residency within 90 days from the date of publication of the law in Israel's official records.

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