

THE TAX DISPUTES
AND LITIGATION
REVIEW

EIGHTH EDITION

Editor
Simon Whitehead

THE LAWREVIEWS

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AND LITIGATION
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PREFACE

The objective of this book is to provide tax professionals involved in disputes with revenue authorities in multiple jurisdictions with an outline of the principal issues arising in those jurisdictions. In this, the eighth edition, we have continued to add to the key jurisdictions where disputes are likely to occur for multinational businesses.

Each chapter provides an overview of the procedural rules that govern tax appeals and highlights the pitfalls of which taxpayers need to be most aware. Aspects that are particularly relevant to multinationals, such as transfer pricing, are also considered. In particular, we have asked the authors to address an area where we have always found worrying and subtle variations in approach between courts in different jurisdictions, namely the differing ways in which double tax conventions can be interpreted and applied.

The idea behind this book commenced in 2013 with the general increase in litigation as tax authorities in a number of jurisdictions took a more aggressive approach to the collection of tax, in response, no doubt, to political pressure to address tax avoidance. In the United Kingdom alone we have seen the tax authority vested with broad new powers not only of disclosure but even to require tax to be paid in advance of any determination by a court that it is due. The provisions empower the revenue authority, an administrative body, to compel payment of a sum, the subject of a genuine dispute, without any form of judicial control or appeal.

Over the past year, the focus on perceived cross-border abuses has continued with, for example, European Commission decisions against past tax rulings in Ireland and the United Kingdom, and the BEPS Project continuing to mould a more aggressive approach to tax legislation and powers. The general targeting of cross-border tax avoidance now has European legislation behind it with the passage last year of the second Anti-Tax Avoidance Directive. The absence of much previous European legislation in direct tax has always been put down to the need for unanimity and the way in which Member States closely guard their taxing rights. The relatively speedy passage of this legislation (the Parent–Subsidiary Directive before it took some 10 years to pass) and its restriction of attractive tax regimes indicates the general political disrepute with which such practices are now viewed.

These are, perhaps, extreme examples, reflective of the parliamentary cycle, yet a general toughening of stance seems to be felt. In that light, this book provides an overview of each jurisdiction's anti-avoidance rules and any alternative mechanisms for resolving tax disputes, such as mediation, arbitration or restitution claims.

We have attempted to give readers a flavour of the tax litigation landscape in each jurisdiction. The authors have looked to the future and have summarised the policies and approaches of the revenue authorities regarding contentious matters, addressing important questions such as how long cases take and situations in which some form of settlement might be available.

We have been lucky to obtain contributions from the leading tax litigation practitioners in their jurisdictions. Many of the authors are members of the EU Tax Group, a collection of independent law firms, of which we are a member, involved particularly in challenges to the compatibility of national tax laws with EU and EEA rights. We hope that you will find this book informative and useful.

Finally, I would like to acknowledge the hard work of my colleague Megan Durnford in the editing and compilation of this book.

Simon Whitehead

Joseph Hage Aaronson LLP

London

February 2020

ISRAEL

*Eran Lempert and Dror Varsano*¹

I INTRODUCTION

The Israeli Tax Authority is the body responsible for the collection of taxes in Israel, both income tax (direct tax) as well as value added tax (VAT, which is an indirect tax). The income tax collection procedure is managed in accordance with the provisions of the Income Tax Ordinance [New Version] 5721-1961 (the Income Tax Ordinance or the Ordinance). VAT is collected in accordance with the provisions of the Value Added Tax Act, 5736-1975 (the VAT Act).

The Israeli Tax Authority is an administrative body, and as such it is subject to the rules of administrative law, including the duty to give reasons, duty of fairness and equality, the provision of a right to claim, and more.

The assessment process may take up to six years from the end of the tax year to which the assessment relates, and a legal proceeding, if necessary, may continue for approximately two to five years in a trial court, and another two to three years in an appeal court. However, most tax disputes are resolved much earlier and most of them do not go to trial. Discussions between the Israeli Tax Authority and the taxpayers, in an effort to reach agreements at the various tax assessment stages, are common. The number of tax disputes that reach the courts is relatively small; this is contrary to the other areas of law in Israel, where litigation is prolific.

Naturally, the cases that reach trial are usually cases in which there is no clear rule or that arise from new technological developments or new legislation. Even when disputes reach the courts, they do not always end in a judgment and often the parties reach settlements during the legal process.

II COMMENCING DISPUTES

i Income tax

The self-assessment stage

In Israel, there is no general obligation to file tax returns. Instead, Section 131(a) of the Ordinance sets forth parameters that determine which taxpayers are required to file tax returns to the Israeli Tax Authority. In accordance with the provisions of Section 131 of the Ordinance and the regulations promulgated thereunder, as a rule and provided that certain conditions are met, an Israeli resident individual will be exempt from the obligation to file a

¹ Eran Lempert and Dror Varsano are partners at Yigal Arnon & Co. The authors wish to thank Ofir Paz, a member of Yigal Arnon & Co's Tax Department for his helpful comments and assistance.

tax return if his or her income was from a salary,² while a company that is domiciled in Israel will be required to file a tax return as a general rule. In addition, foreign residents, individuals and companies, that generate income in Israel will generally be exempt from filing a tax return in various cases in which tax was lawfully withheld at source from the income of the same foreign resident.

The filing of a tax return by the taxpayer constitutes the determination of the income of such person and is also known as a 'self-assessment'. When filing the tax return to the Israeli Tax Authority, the taxpayer pays the tax amount required to be paid under the tax return, which is the undisputed tax amount. Within six months from the receipt of the tax return, the tax assessing officer may make technical adjustments in accordance with a limited list of cases prescribed in the Ordinance.

After the tax return is filed by the taxpayer, the tax assessing officer may examine the details reported in such tax return to ensure that the declaration in such tax return is correct. To the extent that the tax assessing officer has questions or objections regarding the tax return, he or she may contact the taxpayer (generally by contacting the taxpayer's representative) with questions or may request additional materials. This process is the start of the assessment process and is called the stage A assessment.

During stage A, the taxpayer provides documents and clarifications regarding the tax return to the tax assessing officer, all in accordance with the questions and requests of the tax assessing officer. Following the stage A assessment process, the tax assessing officer can approve the tax return as filed by the taxpayer (the self-assessment), and by doing so, the self-assessment becomes a final assessment. Alternatively, the tax assessing officer may determine the taxpayer's income amount in the assessment, to the best of his or her judgment, if the tax assessing officer has reasonable grounds to assume that the tax return filed is incorrect. This kind of assessment may also be made by way of an agreement with the taxpayer.

The deadline for exercising the tax assessing officer's authority in the framework of the stage A assessment is four years commencing at the end of the tax year in which the tax return is filed to the tax assessing officer. In the event that the tax assessing officer does not exercise his or her authority during the aforesaid four years, the self-assessment becomes a final assessment.

In the event that the taxpayer disagrees with the assessment determined for him or her by the tax assessing officer (the assessment to best of the tax assessing officer's judgment), the taxpayer can file an objection within 30 days from the date of receipt of such assessment. The stage for objecting to the stage A assessment is called stage B, and will be discussed in Section III.

ii Real estate taxation

As a general rule, the provisions of the Real Estate Taxation Act³ provide that parties to a real estate transaction are required to provide the real estate tax administrator with a declaration for each real estate transaction prepared by way of a self-assessment, including the amount of tax payable resulting from such transaction.⁴ In the event that declarations are not submitted, the real estate tax administrator may determine an assessment to the best of its judgment

2 Individuals with an annual salary exceeding 651,000 shekels (as of 2018) are required to file a tax return.

3 The Real Estate Taxation Act (Betterment and Purchase), 5723-1963 (Real Estate Taxation Act).

4 Sections 73(a) to 73(d) of the Real Estate Taxation Act.

and by doing so, determine the amount of tax payable for the said transaction.⁵ In addition, failure to timely file a declaration may result in fines levied upon the parties of the real estate transaction.⁶

iii VAT

In the event that a person, individual or company, is registered as an owner of a business, which means registering as a 'licensed dealer', such person is required to file periodical tax reports regarding its overall business activity, which is filed on a monthly or bimonthly basis, depending on the characteristics of such taxpayer and its overall business operations.⁷ The tax report must include the VAT collected by the taxpayer for each of its transactions (Transaction Tax) as well as the VAT amount that the taxpayer will pay in the course of its transactions (Input Tax), and the amount of VAT payable will be the difference between them.⁸

In the event that the taxpayer does not file a periodical tax report on time, the VAT administrator will determine the VAT that the taxpayer is required to pay, considering the scope of its transactions and business operations, and in the absence of such information, based on an estimation of the VAT administrator.⁹

In cases where the taxpayer files a periodical tax report and the VAT administrator is of view that such report is incorrect, the VAT administrator is authorised to assess the VAT owed by such taxpayer or assess the amount of the input tax that can be utilised by such taxpayer, to the best of his or her judgment, within five years commencing at the date of filing the report, and under certain conditions, within 10 years from the aforesaid date.¹⁰

III THE COURTS AND TRIBUNALS

i Income tax (direct tax)

In cases where the tax assessing officer has issued tax assessment based on best of judgment (stage A assessment), a taxpayer who disagrees with such assessment can file an objection with respect to such assessment to the decision of the tax assessing officer. This objection procedure is also named stage B assessment. After its filing, the objection is examined by the tax assessing officer, which means that the objection is examined internally by the tax assessing officer himself or herself, having issued that assessment during Stage A. However, the person in the tax assessing office who conducted the stage A assessment will not be involved in reviewing the objection in stage B.¹¹ An objection must be submitted to the tax assessing officer within 30 days from the date on which the assessment notice was provided to the taxpayer.¹² Once the objection is filed, the tax assessing officer may ask the taxpayer to provide additional information as may be deemed necessary to clarify the dispute. For that purpose, the tax assessing officer may also invite any person and question such person

5 Section 82 of the Real Estate Taxation Act.

6 Section 94a of the Real Estate Taxation Act.

7 Sections 67 and 67a of the VAT Act.

8 Sections 38, 69 and 69a of the VAT Act.

9 Section 76 of the VAT Act.

10 Section 77 of the VAT Act.

11 Section 150a of the Income Tax Ordinance.

12 Section 150(a) of the Income Tax Ordinance.

to retrieve further information.¹³ At the end of this stage, the tax assessing officer may reach an agreement with the taxpayer regarding the tax assessment for which an objection was previously filed, or, if such agreement was not concluded, the assessing officer may determine the assessment by a decree.¹⁴ If the tax assessing officer does not reach an agreement with the taxpayer and does not determine the assessment by a decree within four years from the end of the tax year for which the tax return was filed or within one year from the filing of the objection, whichever is later, the objection will be deemed as approved.¹⁵

Appeal on an assessment – external procedure

Where the tax assessing officer denies the objection filed by the taxpayer, in full or in part, the taxpayer may appeal the decision to the court. The notice of appeal must be filed by the taxpayer within 30 days from the date on which he or she is provided with the assessment by decree.¹⁶ The court that will hear the appeal is the district court in the jurisdiction of the tax assessing officer handling such assessment. The court hearing will be held behind closed doors, unless the court instructs otherwise at the request of the appellant.¹⁷ However, as a general rule, the rulings and decisions of the court are published to the public.¹⁸

The district court is part of the general court system and is an independent body that is separate from the Israeli Tax Authority. Although the state of Israel does not have a unique legal instance that deals with appeals on tax matters, the court judges that hear tax appeals usually specialise in tax laws and only hear cases on tax matters.

The appeal procedure is initiated by filing a notice of appeal.¹⁹ A notice of appeal is a formal document detailing the income amounts and the tax amounts determined by the tax assessing officer, as well as the income amounts and the tax amounts as claimed by the taxpayer.²⁰ Within 30 days from the date on which the notice of appeal was submitted, the tax assessing officer is required to provide the arguments for his or her tax assessment. The assessment arguments will provide an explanation to the rejection of the taxpayer's claims under the objection and the tax return, the manner in which the assessment was conducted, as well as the legal arguments that substantiate the tax assessing officer's assessment.²¹ Within 30 days from the date on which the tax assessing officer's arguments were provided, the appellant shall submit the arguments for its appeal, which must contain all of the appellant's arguments and claims on the matter.²² Thereafter, the hearing is conducted as a standard civil proceeding, within which each party may submit its evidence. Except in special cases, the

13 Section 151 of the Income Tax Ordinance.

14 Section 152 of the Income Tax Ordinance.

15 Section 152(c) of the Income Tax Ordinance.

16 Article 2 of the Court Regulations (Appeals on Income Tax Matters), 5739-1978 (the Rules of Procedure in a Tax Appeal).

17 Section 154(c) of the Income Tax Ordinance.

18 Civil Appeal 2800/97 *Lipson v. Gahal*, PD 53(3) 714 (1999); Leave for Civil Appeal 382/16 *Yahal v. Tel Aviv Tax Assessing Officer 4* (published in the Nevo Database, 13 July 2016).

19 Article 2 of the Rules of Procedure in a Tax Appeal.

20 Article 4 of the Rules of Procedure in a Tax Appeal.

21 Article 5(b) of the Rules of Procedure in a Tax Appeal.

22 Article 5(c) of the Rules of Procedure in a Tax Appeal.

burden of proof lies with the taxpayer.²³ There is no formal time limit on court litigation. In practice, tax appeal process in the district court may take between two to five years from its beginning until the court will issue a final judgment.

Each party has a right to appeal on a district court's judgment to the Supreme Court²⁴ within 45 days from the date of the district court's decision.²⁵ The Supreme Court is the highest instance of the court in the Israeli legal system. The appeal in the Supreme Court on the district court's judgment is held in the form of an appeal in an ordinary civil proceeding. The hearing takes place before a panel of three judges or a larger odd number of judges. As a general rule, the ruling of the Supreme Court ruling is final. In rare cases, however, the president of the Supreme Court may respond to a petition to hold an additional hearing in a judgment by the Supreme Court, when it is found that the ruling by the Supreme Court conflicts with a previous Supreme Court ruling, or it is determined that an additional hearing should be held because of the significance, severity or uniqueness of the ruling given on the matter.²⁶ A taxpayer who files an objection is not required to pay the disputed tax until a decision is made regarding the objection. In the event that the taxpayer files a tax appeal, the tax is not required to be paid until the decision on the tax appeal.²⁷

ii Real estate taxation

A taxpayer for whom an assessment is made may request the real estate taxation administrator, by way of a written objection notice, to perform a second review and modify its assessment.²⁸ An objection will be filed within 30 days from the date on which the taxpayer was provided with the assessment notice. The person in the real estate taxation administrator office who prepared the assessment at the subject of the objection will not be involved in the decision regarding the objection.²⁹ Generally, the real estate taxation administrator must make a decision on an objection within eight months (or one year, if the administrator finds special reasons for extending such period) from the date on which the administrator was provided with the objection notice or within 30 days from the date on which the administrator confirmed that the taxpayer who submitted the objection has provided all of the documents and information that were required to be provided.³⁰ To the extent that a decision by the real estate taxation administrator was not given within the aforesaid period, the objection will be deemed as approved.³¹

A taxpayer that considers itself to be deprived as a result of a decision made by the real estate taxation administrator (in any decision which includes, but not limited to, a decision regarding an objection) may appeal before an appeals committee adjacent to the relevant district court within 30 days from the date in which the taxpayer received the administrator's

23 Section 155 of the Income Tax Ordinance; Additional Civil Hearing 6067/14 *Zeev Sharon Building and Groundwork Contractor Ltd. v. VAT Administrator* (published in the Nevo Database, 6 August 2015); Leave for Civil Appeal 3646/98 *KWA Construction Inc. v. Value Added Tax Administrator*, PD 57(4) 891 (1999).

24 Section 157 of the Income Tax Ordinance.

25 Article 12 of the Rules of Procedure in a Tax Appeal; Section 397 of the Regulations of Civil Procedure, 5744-1984.

26 Section 30 of the Courts Act [Combined Version], 5744-1984.

27 Sections 183 to 185 of the Income Tax Ordinance.

28 Section 87(a) of the Real Estate Taxation Act.

29 Section 87a of the Real Estate Taxation Act.

30 Section 87(d) of the Real Estate Taxation Act.

31 Section 87(f) of the Real Estate Taxation Act.

decision.³² The appeals committee is comprised of a district court judge and two additional members, at least one of whom is a public representative.³³ In practice, the additional members are generally tax professionals (attorneys or appraisers). The procedure of the appeal in front of the appeals committee with respect to the Real Estate Taxation Act is different from the appeal process regarding income tax described above. In that respect, unlike the proceeding with regard to income tax issues, the appeal procedure with regard to Real Estate Taxation Act must be initiated by filing a notice of appeal that also contains the formal details related to the tax amounts, as well as all of the legal grounds for filing the appeal. A decision by the appeals committee can be appealed upon to the Supreme Court in its capacity as a civil appeals court within 45 days from the date of the decision on a legal matter only.³⁴

iii Value added tax (indirect tax)

A dealer for whom a tax assessment based on the best of judgment is made by the administrator, and who disagrees with the administrator's decision, may file an objection within 30 days from the date on which the notice of objection was provided to him.³⁵ The person in the administrator's office who made the decision regarding such objection will not be the one to manage and examine the objection.³⁶ To the extent that the administrator's decision regarding the objection was not provided within one year from the date of its submission, the objection will be deemed as approved.³⁷

The taxpayer may appeal the administrator's decision on the objection to the District Court³⁸ within 30 days from the date on which the taxpayer received the notice from the administrator regarding his or her objection.³⁹ The appeal proceeding with regard to VAT is similar to the appeal proceeding with regard to income tax described above, other than the fact that it is initiated by filing a notice of appeal that also contains the formal details related to the tax matters, as well as all of the grounds on which the appeal is based.⁴⁰ The burden of proof lies with the taxpayer, unless the periodic report that was submitted to the administrator beforehand is supported by duly managed ledgers.⁴¹

IV PENALTIES AND REMEDIES

i Liabilities and fines at the civilian level

Income tax

Failure to pay income tax on time, for any reason, will incur a charge of linkage differences linked to the Consumer Price Index in addition to annual interest of 4 per cent on the unpaid tax amount. Seemingly, the linkage differences and interest are not punitive by their

32 Section 88 of the Real Estate Taxation Act.

33 Section 89(b) of the Real Estate Taxation Act.

34 Section 90 of the Real Estate Taxation Act.

35 Section 82 of the VAT Act.

36 Section 82(e) of the VAT Act.

37 Section 82(d) of the VAT Act.

38 Article 1 of the Value Added Tax and Purchase Tax Procedures (Appeals Procedures), 5736-1976 (the VAT Appeals Procedure Regulations).

39 Article 2 of the VAT Appeals Procedure Regulations.

40 Article 3 of the VAT Appeals Procedure Regulations.

41 Section 83(d) of the VAT Act.

nature but rather reflect the value of money use, although effectively this interest is a high interest rate. By comparison, the interest rate set forth by law for ordinary civil debts, as of 1 October 2019, is comprised of linkage differences based on the Consumer Price Index in addition to annual interest rate of 1 per cent.⁴²

The administrator may reduce the interest rate or the linkage differences or waive both of them completely if it is proven to his or her satisfaction that the arrears caused by the delayed payment was not caused by an action or omission that resulted from the taxpayer's will, and the administrator may, at his or her sole discretion, reduce or waive, as mentioned above, if it is proven to his or her satisfaction that the taxpayer was not aware of the exact amount of its tax liability before submitting the tax report to the administrator.⁴³

Fines are an additional sanction applied by the law. The following are some examples of situations in which fines may be imposed: a delay in filing a report or failure to disclose an action that is required to be reported in the report,⁴⁴ failure to provide information forms by a party required to withhold tax at source for a party from whose payments the tax was withheld,⁴⁵ a party that offset amounts of tax withholding from its advances for which there was no written confirmation, or that such amount were withheld not within the permitted period (a fine in the amount of three times the withholding amount that was unlawfully offset),⁴⁶ a party that did not withhold the tax that was required to be withheld under law (a fine at the rate of 15 per cent of the amounts not withheld),⁴⁷ and false recording of the details of a purchaser that paid in cash.⁴⁸

Another significant sanction is the application of a deficit penalty. A deficit in this regard is the difference between the amount of tax eventually determined to be owed by the taxpayer and the tax amount that was included in the tax return submitted by the taxpayer, or alternatively, the amount of tax determined to be owed by the taxpayer in cases where the taxpayer did not submit any tax return to begin with.⁴⁹ When the deficit exceeds 50 per cent of the tax owed by the taxpayer, and such taxpayer has not proven that it was not negligent in the preparation of the tax return or in the failure to submit it to begin with, the Income Tax Assessor may impose a deficit penalty at a rate of 15 per cent of the deficit amount.⁵⁰ Under certain circumstances, such as when it is determined that the taxpayer has created the deficit maliciously with an intent to evade the payment of tax, or when the taxpayer acted contrary to a tax rulings or failed to report of any reportable tax actions, the administrator is authorised to impose double penalties.⁵¹

42 The Interest and Linkage Regulations (Determination of the Interest Rate and its Calculation), 5763-2003; *Takam* Notice 3.1.0.2.1.E of the Comptroller General Department of the Ministry of Finance.

43 Section 192 of the Income Tax Ordinance.

44 Section 188 of the Income Tax Ordinance; Section 188(g) of the Income Tax Ordinance.

45 Section 188(f) of the Income Tax Ordinance.

46 Section 190a of the Income Tax Ordinance.

47 Section 191a of the Income Tax Ordinance.

48 Section 191c of the Income Tax Ordinance.

49 Section 191(a) of the Income Tax Ordinance.

50 Section 191(b) of the Income Tax Ordinance.

51 Section 191(c) and (c1) of the Income Tax Ordinance.

Real estate taxation

Failure to pay tax on time may result in payment of linkage differences linked to the Consumer Price Index and also an annual interest at a rate of 4 per cent.⁵²

In addition, other fines may also apply in cases where the taxpayer is not in compliance with the law including, inter alia, a fine because of failure to submit a declaration or a notice,⁵³ a fine because of a delay in payment,⁵⁴ and fines for a deficit exceeding 50 per cent of the tax that is determined for a transaction, provided that the deficit is a result of the taxpayer's negligence, in which case the fine will amount to 15 per cent of the deficit amount, and can reach up to 30 per cent of the deficit amount if the taxpayer has acted maliciously with the intent to evade payment of tax.⁵⁵

Value added tax

Failure to pay tax on time may result in payment of linkage differences linked to the Consumer Price Index and also an annual interest at a rate of 4 per cent.⁵⁶

In addition, other fines may also apply in cases where the taxpayer is not in compliance with the law including, inter alia, a fine because of delay in filing a tax return,⁵⁷ a fine because of a failure to properly manage financial records or ledgers or because of failure to manage them at all,⁵⁸ a fine because of failure to pay taxes on time,⁵⁹ a fine because of a transaction or action that were deemed to be a disregarded transaction because of being artificial, fictitious or with the main goal of evading tax payments or improperly reducing tax payments, and such disregard transaction or action resulted in a difference between the tax assessment reported initially by the taxpayer and the final assessment of such taxes by the administrator,⁶⁰ a deficit fine in cases where the amount of the deficit exceeds 500,000 shekels, where the deficit exceeds 50 per cent of the tax owed by the taxpayer (the fine may reach up to 30 per cent of the deficit amount).⁶¹ Furthermore, in the event that collection proceedings are initiated against the taxpayer, the taxpayer will be charged the costs incurred in the same.⁶²

ii Criminal sanctions

A criminal penalty may be imposed on a taxpayer following a criminal proceeding before a court.

52 Section 94 of the Real Estate Taxation Act.

53 Section 94a of the Real Estate Taxation Act.

54 Section 94b of the Real Estate Taxation Act.

55 Section 95 of the Real Estate Taxation Act.

56 Section 93 of the VAT Act.

57 Section 94 of the VAT Act.

58 Section 95(a) of the VAT Act.

59 Section 96 of the VAT Act.

60 Sections 96a and 138 of the VAT Act.

61 Section 96b(a) of the VAT Act.

62 Section 99 of the VAT Act.

Income tax (direct tax)

Unless otherwise provided by law, violation of the provisions of the Ordinance will result in imprisonment of one year or a fine.⁶³ There are explicit tax offences that result in more severe penalties, such as someone who transfers assets with the intent of evading tax collection,⁶⁴ someone who, without a reasonable justification, prepares an incorrect tax return,⁶⁵ certain actions if the taxpayer has acted intentionally with the intent to evade payment of tax or to assist another person to evade tax payment may result in the taxpayer receiving a sentence of up to seven years as well as a fine.⁶⁶

In cases where a corporation has committed an offence, any person who, at the time of the offence, was such active director of the corporation, will be considered guilty as well, unless it is proven that the director was unaware that the offence was committed or that he or she took all of the reasonable measures to ensure the prevention of such offence.⁶⁷

With respect to offences that are 'formal' by their nature and primarily relate to the obligation to submit various tax returns and notices, the taxpayer may be subject to an administrative fine in accordance with the Administrative Offences Regulations (Administrative Fine – Tax Act), 5747-1987. Once the administrative fine has been paid, the relevant offence is effectively cured. Also, proceedings of imposing criminal sanctions under the Income Tax Ordinance may, in certain cases, be converted to payment of a monetary sum.⁶⁸

Real estate taxation

Several violations of the Real Estate Taxation Act by the taxpayer may result in imprisonment of such taxpayer and payment of fines. The imprisonment period and the fine are determined based on the severity of the offence and range between a period of six months and seven years, in cases in which the taxpayer has acted intentionally with the intent to evade payment of tax or to assist another person to evade tax payment.⁶⁹

Proceedings to impose criminal sanctions under the Real Estate Taxation Act, may, in certain cases, be converted to payment of a monetary sum.⁷⁰ Additionally, offences that essentially and primarily concern the duty to submit various notices and reports may result in an administrative fine, pursuant to the provisions above regarding income tax.

Value added tax (indirect tax)

Where a person has committed an offence under the law and no penalty was set forth under law, his or her sentence is three months' imprisonment or a fine.⁷¹

For several violations of the Value Added Tax Act or the regulations enacted thereunder, it is provided that a violating party is subject to imprisonment of one year.⁷² There are also

63 Section 215 of the Income Tax Ordinance.

64 Section 216b(a) of the Income Tax Ordinance.

65 Section 217 of the Income Tax Ordinance.

66 Section 220 of the Income Tax Ordinance.

67 Section 224a of the Income Tax Ordinance.

68 Section 221 of the Income Tax Ordinance.

69 Section 98 of the Real Estate Taxation Act.

70 Section 101 of the Real Estate Taxation Act.

71 Section 118 of the VAT Act.

72 Sections 117(a) and 117(2a) of the VAT Act.

cases in which the penalty is higher. In cases where the violation's goal was to evade tax payment, a higher penalty may be imposed, which is up to five years' imprisonment or a higher fine.⁷³ The same offences, when performed under severe circumstances, may result in seven years' imprisonment or a significantly higher fine.⁷⁴

Proceedings to impose criminal sanctions under the VAT Act, may, in certain cases, be converted to payment of a monetary sum.⁷⁵ Additionally, offences that primarily concern the duty to submit various notices and reports may result in an administrative fine, pursuant to the provisions above regarding income tax.

V TAX CLAIMS

i Recovering overpaid tax

When it becomes apparent, at the time of filing the tax return to the tax assessing officer, that tax has been overpaid, a right for a refund of the overpaid tax may be established if certain conditions are met, which include, inter alia, that the overpayment of tax was based on a tax return submitted by the taxpayer.⁷⁶ Upon the fulfilment of the conditions specified under the law, the taxpayer will receive the overpaid tax balance within 90 days from the day of filing such tax return or on 31 July of the tax year following the tax year for which the tax return was submitted, whichever is later.

When overpayment of tax has become apparent after the assessment stage, its refund is subject to similar conditions that include, inter alia, that overpayment of tax was based on a tax return submitted by a taxpayer, while such tax return was submitted no later than six years afterwards. Upon the fulfilment of the conditions set forth under the Ordinance, the same person will be entitled to a refund of the overpaid tax within one year from the date of the assessment in which the overpayment of tax was determined or within two years from the end of the tax year in which the tax was paid, whichever is later.⁷⁷

The provision regarding a tax refund at the reporting stage only applies to taxpayers that are required to file a tax return under Section 131 of the Ordinance. In contrast, the provision regarding a tax refund at the assessment stage also applies to taxpayers who are salaried employees who are not required to file a tax return; however, in such a case, such taxpayers will be required to file a form in which they provide a declaration with respect to their overall income from any source, which effectively constitutes a tax return.

The limitations period for filing a claim for a tax refund at the assessment stage is six years.⁷⁸ On the contrary, no limitations period has been set for a tax refund in the reporting stage.⁷⁹ The difference between the two sections involves the designation of Section 159a of the Ordinance – the section grants a temporary remedy only until the determination of the assessment. On the other hand, Section 160 of the Ordinance pertains to the final signing of the assessment for a given tax year, and therefore it is necessary to determine a limitations period.

73 Section 117(b) and 117(b1) of the VAT Act.

74 Section 117(2b) of the VAT Act.

75 Section 121 of the VAT Act.

76 Section 159a of the Income Tax Ordinance.

77 Section 160 of the Income Tax Ordinance.

78 Section 160 of the Income Tax Ordinance.

79 Section 159a of the Income Tax Ordinance.

With regard to a claim for a tax refund under Section 160 of the Ordinance, the legislator has provided that the taxpayer is required to first file an objection to the tax assessing officer and can only file an appeal with the district court if the objection is denied. Section 159a of the Ordinance does not set forth a similar provision, and therefore the possibility to appeal a decision of a tax assessing officer will generally occur by way of an originating motion or an administrative petition to the court (i.e., proceedings that tackle the discretion of the Israeli Tax Authority as an administrative body).

ii Challenging administrative decisions

In the event that the taxpayer is involved in assessment proceedings and would like to file an objection or appeal the assessment, it must act as provided in Sections II and III above.

In the event that the taxpayer is not undergoing assessment proceedings and would like to act against a decision of a tax assessing officer, it must file an administrative petition or originating motion to the court (i.e., initiate proceedings that tackle the discretion of the Israeli Tax Authority as an administrative body).

iii Claimants

As a general rule, Sections 159a and 160 of the Ordinance grant the taxpayer a right to receive a tax refund for overpaid tax, whether in the stage of filing the tax return or after the assessment stage. Section 159a of the Ordinance applies to parties that are required to submit a tax return under Section 131 of the Ordinance, while under Section 160 of the Ordinance, as stated above, overpaid tax can be returned to salaried employees as well, who are not required to file a tax return, if they file certain forms of the Israeli Tax Authority in which they declare their income, which effectively constitutes an abbreviated tax return. Therefore, generally, in order to receive the overpaid tax, the taxpayer is required to file a tax return. Accordingly, in the case of a foreign resident who wants to claim a tax refund from the Israeli Tax Authority for taxes that were over withheld at source, the same foreign resident will be required to file a tax return to the Israeli Tax Authority for the relevant tax year, to declare its overall income in Israel, the amount of the tax that was over withheld, and to present the Israeli Tax Authority with the request for a tax refund.

VI COSTS

In the event of an appeal proceeding in a court, whether an income tax appeal or a VAT appeal, the court is authorised to order legal costs and attorney fees at the end of the proceeding in favour of the party who won the case. Legal costs may be ordered specifically for amounts actually expended for the litigation of the case, such as court fees or witness costs, or in an estimated global amount, together with or separate from the attorney fees. Attorney fees are generally not awarded based on the attorney fees actually paid, but rather in an amount that the court deems appropriate, based on the duration of the trial, the disputed amounts, and the conduct of the parties. Usually, the amounts of costs and attorney fees awarded by the courts do not reflect the real costs of the litigation.

VII ALTERNATIVE DISPUTE RESOLUTION

Tax disputes that arise between the taxpayer and the Israeli Tax Authority cannot be decided by way of arbitration or external mediation. However, there is a mechanism in place for preliminary 'tax ruling' (pre-ruling) that enables the clarification of the tax implications of a specific transaction or action in advance.

A tax ruling is defined as a ruling with regard to a tax liability or tax outcome of an action, income, profit, expense or loss of the party that requested the tax ruling with regard to various tax laws, including the Ordinance, the VAT Law and the Real Estate Taxation Act.⁸⁰

Section 158b of the Ordinance also defines a 'tax ruling upon an agreement' as a tax ruling issued by the Israeli Tax Authority by way of an agreement with the applicant, when the main difference between a 'tax ruling' and 'tax ruling upon an agreement' is the fact that the taxpayer can file an appeal on a tax ruling but cannot do so with respect to tax ruling upon an agreement.⁸¹

It should be emphasised that the administrator of the Israeli Tax Authority may issue a tax ruling, while the tax assessing officer is not authorised to issue a tax ruling.

After a taxpayer submits a request for a tax ruling to the administrator, the administrator may act in one of the following ways: (1) issue a tax ruling; (2) issue a tax ruling upon an agreement; (3) issue a tax ruling only if additional taxpayer will be added as an applicant; (4) refuse to issue a tax ruling; or (5) determine that the answer to the request for a tax ruling will be granted by the tax assessing officer by other means that are not a tax ruling.⁸²

A tax ruling may be limited in time, limited with other restrictions, or conditional on certain terms, as provided in the tax ruling. In addition, a tax ruling will not be granted unless the applicant is given a reasonable opportunity to present its arguments and claims.⁸³

As a general rule, a request for a tax ruling may be submitted before or after the date in which the relevant transaction or action took place, provided that the applicant has not yet filed a tax return to the Israeli Tax Authority under Section 131 of the Ordinance that included a reference to such relevant transaction or action. A request for a tax ruling cannot be submitted where the aforesaid tax return has been submitted. The exceptions to this general rule are a request for tax ruling regarding the Value Added Tax Act or the Real Estate Taxation Act, in which the request must be submitted before the date in which such transaction or action took place.⁸⁴

In principle, the administrator may not retract a tax ruling that he or she issued unless in cases where the administrator has found that one of the following has occurred: (1) the administrator was not provided with an information or document required to issue the tax ruling; (2) the circumstances related to the tax ruling were changed; and (3) the administrator was provided with false, incorrect or misleading information.⁸⁵

80 Section 158b of the Income Tax Ordinance.

81 Section 158c(e) of the Income Tax Ordinance.

82 Sections 158c(a) and 158c(b) of the Income Tax Ordinance.

83 Section 158c(d) of the Income Tax Ordinance.

84 Sections 158d(a) and 158d(b) of the Income Tax Ordinance.

85 Section 158f(a) of the Income Tax Ordinance.

VIII ANTI-AVOIDANCE

Under the Israeli legal system, the taxpayer has a right to legitimately plan the steps to minimise its tax liability.⁸⁶ The taxpayer's right to tax planning arises from the constitutional right to property.⁸⁷ However, the right is for legitimate tax planning only. The line that separates legitimate tax planning and illegitimate tax evasion is a thin one. In the judgment on the *Rubinstein*⁸⁸ case, the Supreme Court held that there are two tracks before the tax authorities seeking to view a transaction differently from the manner with which it is presented by the parties: the first track is the track of the general course of law, in which the Israeli Tax Authority may reclassify a transaction or actions by way of the general law outside of the tax laws and determine the tax liability accordingly. The second track is the track of tax laws in the framework of Section 86 of the Ordinance, which provides that the tax assessing officer has the authority to disregard certain transactions or actions that are 'artificial' or 'fictitious'.⁸⁹ The main difference between the authority of the tax assessing officer to reclassify transactions under the general law and the exercise of authority under Section 86 of the Ordinance is that when exercising authority under Section 86 and disregarding an artificial or fictitious transaction, the burden of proof lies with the tax assessing officer.⁹⁰ On the other hand, when the tax assessing officer utilises his or her general authority to reclassify a transaction for tax purposes in accordance with its real economic nature, insofar as the taxpayer disputes the tax assessing officer's position, the burden to prove that the tax assessing officer is wrong and that his or her assessment is incorrect lies with the taxpayer.

Ultimately, transactions and actions are classified for tax purposes based on the principle of economic substance, and the Israeli courts clearly tend to favour the economic substance of a transaction or action over its formal classification under the tax law.⁹¹ The true economic

86 Civil Appeal 3415/97 *Tax Assessing Officer v. Rubinstein*, 57(5) 915, paragraph 9 (2003); Civil Appeal 4639/91 *Real Estate Betterment Tax Administrator v. Hazon*, PD 48(3) 156, 167 (1994).

87 Civil Appeal 2965/08 *Style Communications Services Ltd. v. Tax Assessing Officer Petah Tikva*, paragraph 17 (2011). In the aforesaid paragraph, the Honorable Justice Rivlin stated the following: 'The right to tax planning, as stated, is a constitutional right that comes to realise the protection of the right to private property.'

88 Civil Appeal 3415/97 *Tax Assessing Officer v. Rubinstein*, 57(5) 915, paragraph 6 (2003). In the aforesaid paragraph, the Honorable Justice A. Barak stated that 'the Tax Assessing Officer that is seeking to view a transaction differently from the manner with which it is presented by the parties to the transaction has two tracks available: the first track is the track of the general course of law, and under the circumstances of the case, corporate law . . . The second track is the track of the anti-avoidance track under tax laws, which is set forth in Section 86.'

89 Civil Appeal 3415/97 *Tax Assessing Officer v. Rubinstein*, 57(5) 915, paragraph 9 (2003). Civil Appeal 3365/06 *Dorfberger v. Haifa Tax Assessing Officer* (2010) and Administrative Petition 41442-02-12 *Gabriel v. Jerusalem Tax Assessing Officer* (2013).

90 Section 86 of the Income Tax Ordinance; See also Civil Appeal 750/16 *Sadtamand v. Rehovot Tax Assessing Officer*, published in the Nevo Database (2019).

91 In this regard, see for example: Civil Appeal 6722/99 *Tel Aviv VAT Administrator v. Mishkenot Clal*, paragraph 9 (2002). In the aforesaid paragraph, the Hon. Justice A. Barak held that 'the essence of a transaction is designated by the real economic substance of the transaction for purposes of tax laws'. The name of the transaction or its designation by its parties is not determinative of the nature of the transaction for the purpose of tax laws. This principle has been an accepted principle in tax law for years. See also: Additional Hearing 16/82 *Tax Assessor v. Lidor* (1985); Leave for Civil Appeal 5472/98 *Betterment Tax Administrator v. Hadarei Hachof* (2001); Civil Appeal 265/67 *Mapi Ltd. v. Large Enterprise Tax Assessing Officer* (1967).

substance of a transaction is examined based on all of the relevant evidences, and often relies on the business or commercial purpose of the transaction, beyond the taxpayer's aspiration to reduce his or her tax liability.

As can be seen from the description above, the anti-avoidance rules in Israel are very broad. Moreover, as a general rule, the Israeli Tax Authority tends to exercise its assessment authority based on the economic substance principle and accordingly, the interpretation of the Israeli Tax Authority to law, professional circulars and tax ruling that are published by the Israeli Tax Authority tend to apply this principle.

IX DOUBLE TAXATION TREATIES

Section 196 of the Ordinance provides that a treaty for the prevention of double taxation that has been determined in an order by the Minister of Finance as in force in Israel will be valid notwithstanding the provisions of any legislation. In other words, the provisions of the treaty prevail over the domestic law in Israel. Moreover, the provisions of the treaty also prevail over later legislative provisions, while ordinary domestic legislation does not prevail over later conflicting legislation. However, to benefit from provisions regarding reduced rates of withholding tax at source in accordance with the provisions of the treaty, the taxpayer must seek approval of the Israeli Tax Authority in advance. A request of this kind will involve an examination on the part of the Israeli Tax Authority regarding the application of the treaty to the same case.

As stated, the provisions of the treaty prevail over conflicting domestic legislation. However, provisions of the domestic law that do not conflict with the double tax treaty remain in force. In this context, the position of the Israeli Tax Authority is that the general provisions of domestic law, such as the provisions of Section 86 regarding an artificial transaction (see the discussion above) remain in force and can be applied, even when the parties are subject to a double tax treaty.⁹² In addition, in accordance with the position of the Israeli Tax Authority, the double tax treaties aim to benefit the taxpayer and not burden it. Therefore, despite Section 196 of the Ordinance, in the event that any double tax treaty imposes a higher tax on the taxpayer, the provisions of Israeli domestic law will prevail over the provisions of the double tax treaty.⁹³ In the early 2000s, the Israeli Tax Authority published professional circulars and interpreted various terms in the double tax treaties that Israel has signed. In one of the circulars,⁹⁴ the Israeli Tax Authority published its position on 'beneficial ownership' and through this interpretation, the Israeli Tax Authority effectively added requirements regarding foreign resident taxpayers seeking to claim tax benefit under the double tax treaty, such as the business substance in the relevant contracting country, the business purpose for the structure of foreign companies, and so on. In this manner, the Israeli Tax Authority sought to avoid situations where tax benefits are provided under tax treaties in cases in which the provisions of the treaty are abused.

In 2017, Israel signed the MLI Agreement,⁹⁵ which took effect in Israel at the start of 2019. Within the MLI Agreement, certain amendments will take effect with regard to the

92 Income Tax Circular 3/2001, Prevention of Tax Planning based on Treaties for the Avoidance of Double Taxation.

93 The interpretation file of the Income Tax Ordinance, Section 196 of the Income Tax Ordinance.

94 Income Tax Circular 22/2004.

95 The Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS.

double tax treaties signed by Israel, mainly to ensure that the tax treaties are not abused by the taxpayers for the purpose of base erosion and the transfer of profits to countries with lower tax rates.

There are not many decisions by the Supreme Court in Israel regarding double tax treaties, and most of the case law on the matter is at the district court level. In the *Gmol America* case,⁹⁶ the district court held that the purpose of a tax treaty is, inter alia, to prevent double taxation. Accordingly, recognition of unpaid tax because of offsetting losses does not serve this purpose. In addition, the credit rules set forth in the double tax treaty are subject to Israeli domestic law, as long as the Israeli domestic law does not violate the general principle of the treaty, which is the prevention of double taxation. Another case in the *Yanko Weiss* case,⁹⁷ where the district court held that a tax treaty is intended primarily to create a situation in which a taxpayer who is trapped in the tax net of two contracting countries is not exposed to the payment of double taxation. However, double tax treaties are not intended to be used bona fides or used in a manner that constitutes abuse thereof. In addition, the contracting countries of a treaty are entitled to make claims against this by virtue of provisions of domestic law, such as the anti-avoidance norms, while ensuring that the taxpayer is not exposed to double taxation. In addition, in the framework of the *Tova* case,⁹⁸ the Supreme Court held that although Section 196 of the Ordinance provides that tax treaties prevail over Israeli legislation, this does not require the Israeli court to stay a pending proceeding in any case in which a petition is made to hold mutual consent proceedings under a double tax treaty. In the *Alfasi* case, the district court held that the interpretation of the domestic law more broadly in light of the provisions of double tax treaty is not possible, even if this interpretation leads to a more harmonious or equitable result.⁹⁹ In addition, in the *Kenig* case, it was held that the provisions of the double tax treaty may prevail over an exit taxation charges levied under Israeli domestic law only in cases in which the taxpayer is able to prove that he or she sustained double taxation at an international level.¹⁰⁰

X AREAS OF FOCUS

One of the issues to which the Israeli Tax Authority has been devoting significant attention in recent years is transfer prices and business restructuring. The Israeli economy is characterised by entrepreneurial activity in the technology sector, which is accompanied by acquisitions of local startup companies by multinational corporations. In many cases, the Israeli Tax Authority claims that in the framework of these transactions, not only are shares of the Israeli startup companies transferred to the control of foreign multinationals, but such Israeli startups are also transferring their assets abroad, and primarily their intangible assets. The Israeli Tax Authority is acting to tax such transfers of intangible assets outside of Israel under taxation referred to by the Israeli Tax Authority as 'business restructuring'. The Israeli Tax

96 Tax Appeal 49525-02-14 *Gmol America Ltd. v. Tel Aviv Tax Assessing Officer* 5 (2016).

97 District Misc. Civil Motions 5663/07 *Weiss v. Holon Tax Assessing Officer* (2007). See also Tax Appeal (Tel Aviv) 31489-01-13 *Kenig v. Tel Aviv Tax Assessing Officer* 3, paragraph 105 (2015).

98 Leave for Civil Appeal 9615/17 *Tova Manpower v. Ashkelon Tax Assessing Officer* (2017).

99 Tax Appeal (Tel Aviv) 1292/07 *Alfasi v. Ramla Tax Assessing Officer*, paragraph 24 (2012).

100 Tax Appeal (Tel Aviv) 13807-01-17 *Kenig v. Tel Aviv Tax Assessing Officer* 3, paragraph 102 (2015). The Supreme Court also denied the appeal filed by the taxpayer in this case, thus upholding the district court ruling. See Civil Appeal 5694/18 *Kenig v. Tel Aviv Tax Assessing Officer* 3 (2019).

Authority has published guidelines on the matter¹⁰¹ in which it has worked to define a business restructuring as one usually involving the transfer, including liquidation, of functions, assets and risks (FAR), and the profit potential involved in the same from the Israeli company to the international corporation to which it belongs. This publication by the Israeli Tax Authority followed a precedent ruling that approved taxation of startup companies that are acquired by an international corporation for imputed income from the sale of FAR as a result of a business restructuring.¹⁰² The application of the new ruling and the income tax circular sparked significant litigation, and this trend is expected to continue in the near future.

Another issue that has been the subject of considerable litigation in recent years and is expected to continue to spark litigation is the question of residence for tax purposes of individuals, particularly individuals with international careers, such as actors, models, athletes and so on. Two examples from recent case law are the cases of the international Israeli model and the Israeli poker player with an international career.¹⁰³ This issue is also expected to continue to engage the Israeli Tax Authority and the courts in light of the growing integration of Israel and its residents into the global market.

Finally, in light of the increasing involvement of Israeli residents in international transactions and the extensive changes in international taxation, both globally as well as in Israeli domestic tax law, there is a trend in case law on additional matters related to international taxation such as foreign tax credits and foreign controlled companies, and this trend is expected to continue in the coming years as well.

XI OUTLOOK AND CONCLUSIONS

The increased volume of cross-border transactions involving Israeli resident taxpayers generates tax matters involving international aspects. Because the Israeli case law regarding international tax aspects is not well developed, there were over the recent years many court decisions regarding international tax aspects such tax residence, foreign tax credit and more. We anticipate that this trend of international tax disputes getting to court and being litigated will continue in the near future and that a significant number of such cases will also be litigated in the Israeli Supreme Court. As mentioned above, currently there is a line of disputes with the Israeli Tax Authority regarding business restructuring cases, and it seems that at least a few of such cases will be litigated over the next few years and most likely will be ultimately decided in the Israeli Supreme Court. We believe that eventually these court decisions regarding international tax aspects will create a significant body of Israeli case law regarding international tax.

101 Income Tax Circular 15/2018 'Business Restructuring in Multinational Companies' (1 November 2018).

102 Tax Appeal 13-01-49444 *Jitco Ltd. v. Kfar Saba Tax Assessing Officer* (published in the Nevo Database, 6 June 2017).

103 Civil Appeal 476/17 *Amit v. Tel Aviv Tax Assessing Officer 4* (published in the Nevo Database, 9 October 2018); Tax Appeal (Central District) 6418-02-16 *Rafaeli v. Kfar Saba Tax Assessing Officer* (published in the Nevo Database, 10 April 2019).

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