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Recent Developments in International Taxation Israel

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Recent highlights

During 2023 and the beginning of 2024, the focal advancements concerning tax and international taxation in Israel revolved primarily around pivotal legislative measures and procedures that we anticipate witnessing.

Over the last few years, Israel has undergone significant shifts and developments, with the trajectory of its legislative processes notably affected by frequent changes in government. However, a significant change occurred in October 2023 when Israel found itself thrust into a state of war. Without delving into political aspects, it is clear to all that during wartime, legislative processes and/or actions that are not relevant or essential to the war effort are pushed aside.

Despite this, one notable area of ongoing reform is the realm of international taxation within Israel because, for many years, the Tax Authority has been working to implement a comprehensive reform regarding various aspects of international taxation in Israel. This reform spans various facets, ranging from the determination of residency status to the implementation of an ‘exit tax’ for individuals seeking to depart from the Israeli jurisdiction while residing in another country.

Prior to the release of the preceding report, a series of impending changes and reforms within the Israeli tax framework were issued for public review. While some of these notices have already transitioned into legislative action, such as amendments regarding reporting obligations for Israeli residents, others remain in the legislative pipeline. Given the current context of wartime, it is plausible that these proposed reforms, which currently exist in a tentative capacity, may find their way into formalised law.

Over the following sections, we delve into each of these aspects (and others), providing a detailed examination of the ongoing legislative landscape and its implications for taxation in Israel.

Amendment of the Israeli income tax ordinance: new reporting obligations for immigrants and returnees

For many years, extensive tax benefits have existed under Israeli law for individuals who became Israeli residents for the first time or returned after more than a decade outside Israel. The rationale behind these benefits was Israel's intention to encourage immigration and bring back the minds of those who left Israel and settled in other countries. The legislator at the time granted extensive benefits to those 'immigrants' or 'returnees', thus almost eliminating tax considerations when deciding whether to relocate to Israel, for a period of ten years.

One of the well-known benefits was the exemption from the reporting obligation in Israel for ten years from the date of a person's conversion to Israeli residency regarding income and/or assets outside Israel. In practice, this created a situation where many individuals were not required to report income and/or assets anywhere in the world for an uninterrupted period of time.

In recent years, with the expansion of transparency and reporting among countries (especially among Organisation for Economic Co-operation and Development (OECD) member countries), criticism has arisen regarding the existing policy, particularly by the Global Forum operating under the OECD.

In March 2024, before the draft recommendations of the Global Forum were published, a bill was proposed (and has been approved), revoking the exemption from the reporting obligation for first-time Israeli residents and returning residents (effective from 2025), and implementing the necessary adjustments regarding trusts that include individuals who benefited from the same exemption (the trustees are obliged to file a report).

It is important to emphasise that while this entails the revocation of a significant benefit, it does not negate the exemption from taxes those residents were entitled to on their arrival in Israel.

Ultimately, regarding trusts and trustees in those trusts currently benefitting from the ten-year benefit period, it is important to note that reporting obligations will also apply to these trusts starting from 2026, even for those individuals eligible for benefits before the end of the ten-year period.

Given that numerous trusts are overseen by trustees from abroad, it is strongly advised that these trustees seek guidance concerning the reporting requirements that such trusts must adhere to.

Crypto regulation

In recent years, the market for cryptocurrencies has been growing and expanding. The development of the crypto market and the fluctuation of currency prices have created significant profits for many (sometimes even leading to enrichment) in a relatively short time. In Israel, the banking system is considered to be very developed, yet conservative. Israeli banks sometimes encounter difficulties with transfers between a person's personal accounts located in different countries. Therefore, it is not surprising that, for years, Israeli banks have refused to accept funds originating from cryptocurrency income.

Simultaneously, the Israeli Tax Authority seeks to tax capital gains from the sale of cryptocurrencies, but does not accept funds from foreign banks for tax payments. Here lies the problem. A person sells cryptocurrencies, makes a decent profit, transfers the funds to a Swiss account in his/her name and seeks to transfer the money to Israel for the tax payment. The Israeli bank refuses to accept the funds, thus, even those who do not intend to avoid paying taxes cannot settle their tax obligations.

About a year ago, the Supreme Court dealt with the refusal of Discount Bank to allow the deposit of funds derived from bitcoin sales. The ruling was given after an Israeli district court dealt with the same question, which ultimately led to the clarification of banking regulations by the Bank of Israel, while stating that refusal to accept funds derived from bitcoin is not permissible. It should be noted that a few months after the ruling, an appeal was filed with the Supreme Court, given the complexity involved in depositing funds even after the ruling.

Following the appeal, the Tax Authority published a procedure (for now for a six-month period) allowing the receipt of funds due to profits from decentralised electronic means. The procedure permits the receipt of funds from banks outside Israel (including accounts on cryptocurrency trading platforms), provided that the Israeli banking system refuses to accept the funds.

On the surface, this appears to be a positive development. However, the procedure is fraught with complexities and difficulties. First, only tax payments can be transferred, and in new Israeli shekels. Second, the refusal to collect the monies from at least one Israeli bank is required, which can sometimes take several months (meanwhile, interest continues to accumulate on the tax liability), and only then can the application process with the Tax Authority commence. Third, the Tax Authority imposes additional difficulties within the procedure; for example, no refunds will be granted for applications regarding these payments unless they were previously reported, and more.

Pending tax reform

In recent years, the Israeli Tax Authority has been working on formulating comprehensive residency determination reforms for individuals, either as Israeli residents or foreign residents. Today, an individual is considered a resident for tax purposes in the State of Israel if the centre of his/her life is located in Israel, based on a combination of quantitative (days of presence) and qualitative (where the individual's economic and social interests are primarily located) criteria, which closely resemble the tests established in various tax jurisprudence signed by the State of Israel.

Over the years, there have been numerous court rulings in Israel that have clarified that the status of the residency of an individual shall be based on his/her centre of life rather on actual periods of stay for the purpose of residency determination. This situation, which is based on qualitative criteria subject to wide interpretation by individuals and their representatives, led the Tax Authority to work on developing a comprehensive reform to strengthen the validity of residency status. It is most important to mention that this reform is not intended to undermine established tests in the various tax jurisprudence to which the State of Israel is a party.

Essentially, these provisions create complexities in the actual relocation or change of residency according to Israeli law, especially because many people nowadays roam around the world and stay in different countries for prolonged periods without establishing roots.

As mentioned above, this reform is not intended to undermine the established ‘tie breaker’ tests in the various double taxation treaties to which the State of Israel is a party. Essentially, if an individual disconnects his/her residency from Israel and moves to another country (of which Israel has a signed double taxation treaty), even if Israeli law considers the individual a resident of Israel, the tests established in the other country may sway the determination towards that country. However, it is not the case when someone moves to a country that does not have a tax treaty with Israel to avoid double taxation. Because Israel has signed 72 treaties to prevent double taxation, there may indeed be cases where determining an individual’s residency becomes challenging.

This reminder has not yet reached the level of binding legislation; however, it is believed that this change, which is a fundamental part of the international tax reform under consideration, which includes a change in the definition of controlled foreign companies (CFCs) and professional foreign companies (PFCs) (in which it was requested to create a distinction between companies located in a country with which Israel has a signed double taxation treaty or not), the allowance of foreign tax credits and more will either be fully or partially implemented in the near future.