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# Israel Implements BEPS Action 13

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The implementation of Action 13 “Transfer Pricing Documentation and Country-by-Country Reporting” into Israeli legislation will greatly increase the data provided by taxpayers to local and foreign tax authorities and impose heavier reporting requirements on taxpayers.

## I. Introduction

In October 2015, the OECD published its Action Plan on Base Erosion and Profit Shifting (“BEPS”), comprised of 15 Action Plans (“Report”). The BEPS Action Plan addresses the erosion of tax due to the diversion of profits between countries by multinational enterprises (“MNEs”). Action Plan No. 13, “Transfer Pricing Documentation and Country-by-Country Reporting” (“Action 13”), deals with developing rules regarding transfer pricing documentation and reporting requirements for cross-border transactions between related parties. The purpose of Action 13, inter alia, is to provide rules regarding transfer pricing documentation that will enhance transparency for tax administrations when dealing with MNEs, by providing them with the required information to conduct transfer pricing inquiries and audits.

In order to facilitate this increased transparency, Action 13 recommends a three-tiered standardized approach to transfer pricing documentation:

- (i) tier one requires MNEs to provide tax administrations with high-level information regarding their global business operations, their transfer pricing policies as well as information on allocation of their income and economic activities so that the tax administrations could more efficiently evaluate the presence of significant transfer pricing risk. Such information is to be provided in a “master file” that is to be available to all relevant tax administrations;

- (ii) tier two requires that detailed transactional transfer pricing documentation be provided in a “local file,” referring specifically to transactions taking place between a local country affiliate and associated enterprises in different countries and which are material in the context of the local country’s tax system. The local file should contain the amounts involved in those transactions, and the company’s analysis of the transfer pricing determinations they have made with regard to those transactions; and

- (iii) tier three requires MNEs that meet certain conditions (such as that the MNE’s annual revenue is above a certain threshold) to file a Country-by-Country Report (“CbCR”) in the residence country of the ultimate parent company and in each tax jurisdiction in which the MNE operates, as a way to exchange information between countries. The CbCR shall include information regarding MNE’s activity, inter alia, the amount of revenue, profit before income tax and income tax paid and accrued in each jurisdiction. According to Action 13 the MNE is required to identify each entity within the group doing business in particular tax jurisdiction and to provide an indication of the business activities each entity engages in. Action 13 recognizes that its implementation in domestic legislation will create various complexities and thus it is recommended that the first CbCR of all OECD countries be filed in 2017. The implementation of Action 13 into Israeli legislation will greatly in-

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crease the data provided by taxpayers to local and foreign tax authorities and impose heavier reporting requirements on taxpayers.

## II. Current Reporting Requirements in Israel

According to the long-standing Israeli general legal principles, all transactions, including international transactions should be made at fair market value. However, it was only in 2003, upon a major tax reform in Israel, that transfer pricing provisions requiring all cross-border transactions between related parties to be carried out at arm's-length terms were enacted. The enacted section 85A of the Israel Tax Ordinance ("ITO") incorporated the arm's-length principle, which applies to any international transaction in which there is a special relationship between the parties to the transaction. These provisions came into effect upon issuance of final transfer pricing regulations in 2006 ("regulations").

According to section 85A of the ITO, a taxpayer is required to provide the ITA, if requested, with information regarding the transaction and with respect to the foreign related party to the transaction and the method used to determine the transaction price.

According to the regulations, in order to examine whether the international transaction was at arm's length, the parties are required to conduct a transfer pricing study ("study"). The study compares a transaction carried out between related parties to similar transactions between unrelated parties in order to determine if the transaction is at arm's length. The regulations provide that an assessing officer is entitled to request the taxpayer to submit such study which will specify, inter alia, the data of the international transaction and the parties to the transaction and will examine similar transactions and the market prices.

In addition, the regulations provide that every taxpayer who is a party to an international transaction is required to submit a form (1385) along with its annual report with respect to each transaction detailing the parties to the transaction, a short description of the transaction, situs of the parties and the price of the transaction.

## III. Implementation of Action 13 in Israeli Legislation

As part of Israel's budget approval for the years 2017-18, the Israeli Tax Authority ("ITA") proposed to amend current law to adopt the recommendations of Action 13 by requiring taxpayers to prepare and file a CbCR of MNEs in Israel and to file additional information with respect to foreign companies which are a party to the MNE and thus, as a part of this, information with respect to other entities with whom such entities conduct their business. It was suggested to provide the Minister of Finance with the power to establish rules with respect to the form and substance of the files.

However, the amendments dealing with reporting of international transactions were not adopted in the final budget bill and on January 4, 2017 the suggested amendment was presented in a separate bill ("Bill"). The following is a short summary of the main changes proposed in the Bill.

### A. Multinational Group Reporting Requirements

The Bill presents an old/new concept of "Multi-National Group" ("MNG"). According to this concept, an entity fulfilling certain conditions shall be subject to additional reporting requirements. According to a definition provided in the Bill, an MNG is a group which consists of two or more entities which fulfil the following conditions:

- (i) at least one of the entities is a foreign resident;
- (ii) the means of control of one of the entities are held directly or indirectly by another so that one of the following takes place:
  - (a) a special relationship exists between the entities or;
  - (b) the entities had to prepare consolidated accounting reports in accordance with generally accepted accounting principles, or they would have been required to do so had one of the entities been traded on the stock exchange.

According to the Bill, an Israeli entity which is party of MNG shall be required to file along with its annual reports a form declaring to the ITA that the entity is part of the MNG. In this regard, the Bill does not provide any guidance as to the question who shall be treated as part of MNG. In addition, according to the Bill, at the request of an assessing officer, a taxpayer who is a part of MNG, will be required to provide the assessing officer, inter alia, with the following data and reports:

- (i) all documents and data relating to the transaction or to a party to the transaction that is a foreign resident or any other entity in the MNG that is a party to such transaction;
- (ii) the method for determining the transaction price and terms of the transaction; and
- (iii) documents and data relating to the MNG.

Once the taxpayer submits the information per the assessing officer's request the assessing officer shall bear the burden of proof to show that the transaction was different than reported by the taxpayer. Such requirement is no different than the already existing requirement in the current legislation with respect to claims the assessing officer makes regarding any international transaction an Israeli entity is a party to, however, in view of the breadth of information that can be required it might become more difficult to transfer the burden of proof to the assessing officer.

## **B. Ultimate Parent Company of the MNG is an Israel Tax Resident—CbC Reporting Requirements**

The Bill proposes to make a requirement that MNG, whose ultimate parent company (“UPC”), or another company authorized by the assessing officer, is located in Israel, and is required according to the already existing legislation to submit an annual report, including financial and business data of the entity shall submit an additional information with respect to all the entities that are part of the MNG.

The Bill proposes that an Israeli tax resident UPC which is a part of an MNG with a turnover of transactions exceeding 3.4 billion shekel (which is approximately 750 million euros as was recommended by the OECD) (“Threshold”), the UPC shall submit to the assessing officer a report regarding the MNG and its activities in each country for the tax year, online and within a year from the end of the fiscal year. Moreover, the Bill provides the Minister of Finance with the power to set a lower Threshold in this regard and to request any kind of information with respect to the MNG.

In addition, the Bill proposes that an entity that violates its obligation to report will be viewed as if it did not file its tax returns. However, according to the Bill, such entity may request permission from the ITA that another entity of the MNG shall submit such report and such report shall be filed to the ITA.

It is further proposed, to authorize the Minister of Finance with approval by the Finance Committee to determine:

- (i) information to be included in the report;
- (ii) rules regarding the authorization of alternative parent entity; and
- (iii) rules according to which a company in a MNG, Israeli resident, can be coerced to submit such report even if the said conditions do not apply to it. It seems that the current draft provides the Minister of Finance with extended authorities to set rules and requirements without being subject to the recommendations of the Report.

The Bill does not specify the effective date when the proposed amendments shall become effective, however, it seems that the implementation of the proposed amendments would be retroactive to the 2016 tax year in order to meet the OECD’s deadlines.

## **IV. Conclusion**

Israeli policy makers are trying to adopt the OECD recommendations to the maximum extent possible and to incorporate the new standards into Israeli domestic legislation. The implementation of these new standards will align Israel with other OECD countries in their joint efforts to allocate profits to, and tax them in, the appropriate jurisdiction. At this stage we can only wait and see what will ultimately be adopted in domestic legislation and the effect of such legislation on the domestic and global markets.

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