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## **New ITA Voluntary Disclosure Procedure**

On September 7, 2014, the Israeli Tax Authority ("ITA") published a new Voluntary Disclosure Procedure ("VDP"). The VDP is a unique administrative procedure allowing taxpayers to cure past failures, such as declaring income and assets that they had not previously reported. The ITA generally undertakes not to open criminal proceedings against eligible taxpayers.

The new VDP replaces the voluntary disclosure procedure that had been in effect since 2005 including a temporary order that was issued in 2011. The essential provisions of the new VDP are described below.

### **A. Voluntary Disclosure**

1. Eligibility Preconditions - In order to be eligible for the new VDP, the following preconditions (among others) generally must be met:

1.1. The Voluntary Disclosure must be honest, complete and made in good faith.

1.2. At the time of applying for the VDP, none of the applicant, his/her spouse, or any company controlled by either of them is under investigation or inquiry by the ITA or by the police, and the ITA does not already have the information disclosed in the VDP.

1.3. The income disclosed in the VDP is not an income derived by illegal activity.

1.4. The taxpayer has not previously utilized the VDP (*i.e.*, a taxpayer is entitled to the VDP only once).

2. Depending on the circumstances, the ITA has the authority to and may waive some of these

conditions depending on the taxpayer personal status (e.g., age, illness, etc.), or in some cases, when the information held by the tax authority is not directly or indirectly related to the application.

3. Once the taxpayer has submitted the VDP application, the ITA will determine whether the taxpayer is eligible for the VDP (based on the requirements described in paragraphs 1 and 2 above). If the ITA approves the application, the taxpayer would be protected from criminal proceedings with respect to the matters included in the VDP application. The VDP does not protect the taxpayer from liability for interest, indexation and civil penalties. The ITA will notify the applicant and forward the process to the applicable department within the ITA such as an income tax assessor, director of real estate taxation, or VAT station manager in order to determine the tax liability.

4. The purpose of the VDP is to encourage taxpayers, who failed to report their full income, to voluntarily disclose it without the fear of criminal proceedings being initiated against them. This privilege is conditioned upon full payment of the tax amount, including interest, indexation and civil penalties, as determined by the ITA.

## B. Anonymous Applications

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5. In addition to the publication of the new VDP, on September 7, 2014, the ITA also issued a temporary order (the "**Temporary Order**") according to which, in certain circumstances, the disclosure procedure may be conducted on a no-names basis. Such anonymous application must include all relevant information (other than taxpayer's name) and will be reviewed first by the ITA's criminal division and then referred to the relevant local ITA Assessing Officer to negotiate and determine the "civil" tax liability. Within 90 days from the receipt of the application by such civil department, the taxpayer's name and details must be submitted. This period can be extended for an additional 90 days. In the case that the applicant does not provide such details, the application will be rejected. This procedure enables the taxpayer to determine the "cost of removing its failures" before deciding whether to provide his details to the ITA or to continue the current situation of "living in sin".

Indeed, only after the applicant provides its name, the ITA would be able determine whether they have prior information with respect to him as described in Section 2 above (which might eliminate his eligibility for VDP). Therefore, only after providing its name the applicant would finally know if he might be entitled to the protection from criminal proceedings.

6. The Temporary Order is in effect for one year from its publication and is subject to the provisions of the regular VDP as described above.

## C. Fast Track

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7. The Temporary Order also provided a fast track procedure for applications involving undeclared assets that do not exceed NIS 2 million and the taxable income derived from such assets that does not exceed NIS 0.5 million.

8. Applications in the fast track may not be submitted anonymously; although anonymous applications may be transferred to the fast track. The fast track is subject to the general provisions of the VDP.

## **D. Offsetting Losses**

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9. The Temporary Order provides that losses disclosed in the VDP might be available to offset only business income or capital gains, as applicable, which were first disclosed within the VDP and in the taxable years included in the VDP. Losses which are not used may not be carried forward to subsequent years. In addition, the taxpayer will not be allowed to use “previously declared” losses to offset “VDP declared” profits.

## **E. General Provisions**

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10. The new VDP is in effect from the date of its publication until December 31, 2016, and it replaces any previous procedure with respect to voluntary disclosure.

11. In the case that the VDP request is not approved by the the ITA, the, ITA would not use the information provided in the application in any civil or criminal proceedings. Based on past experience, it appears that the ITA has respected this commitment.

12. The ITA has stated that the VDP will not apply to cases where the resulting tax is “insignificant”. They have not however, defined what “insignificant” means and apparently will decide on a case-by-case basis.

## **F. Notes and Remarks**

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13. The new VDP does not provide answers to all the recently raised questions regarding voluntary disclosures. For example, it is unclear as to the relationship between the new VDP and the information inquiry forms, which were recently sent by the ITA to thousands of taxpayers to declare their sources of income and their bank accounts. However, it seems that the spirit of the new VDP is to enable significant tax collection in a short period of time by encouraging taxpayers to voluntarily disclose previously unreported income without fear of potential criminal sanctions.

14. It should be noted that the emerging trend from the new VDP in comparison to previously published voluntary disclosure procedures is that although the new VDP contains certain beneficial procedural relief, the substantive result is worse. While in the past the ITA expressed its willingness to waive interest and penalties, under the new VDP the full tax liability will generally include interest and penalties. A possible reason for this is the shift toward greater transparency and less confidentiality in the international banking systems, and the expansion of information exchange arrangements between tax authorities of different countries.

15. It should be noted further that VDPs may be long and complex procedures, especially in the case of unreported income earned outside of Israel and which was deposited in banks abroad. As part of the VDP application, the taxpayer will need to provide the ITA all the information with respect to these accounts and income, which may require significant effort on the part of the

taxpayer and its advisors to collect the information, analyze it and prepare the necessary calculations in order to minimize the tax burden.

**16.** There are many situations that the current VDP does not address. For example, dealing with taxpayers who are considering similar procedures in other countries, taxpayers who have tax responsibilities in other countries (especially U.S. citizens) and other measures designed to avoid double taxation. Careful consideration of these issues is required before initiation of a VDP process.

**17.** Anyone with undeclared income and/or assets should seriously consider taking advantage of the current VDP. Israel is in the process of entering into information exchange agreements with many countries and the OECD has adopted various standards which are expected to proliferate into and be implemented by tax authorities and financial institutions. The combination of the attorney-client privilege which governs the communication and information provided by a client to its lawyers, with the anonymous option may provide a unique opportunity. Taxpayers who are considering the VDP should seek counsel from lawyers who are competent in this field.

This memorandum is provided for information purposes only and does not constitute tax advice or a tax opinion; therefore, it should not be implemented without consulting with the relevant personnel of our firm.

If you have further questions related to this document, please contact the lawyers specified below or directly with your contact person in the office:

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