



Client Update | Tax | New District Court Ruling

The Israel Tax Authority is not Bound by the Statute of Limitation Rules when Imposing Tax on Unreported Income

July, 2019

Dear Clients, Colleagues and Friends,

A new District Court ruling in the case of **Avner Nukrai v. The Israel Tax Authority** approves the practice of the ITA to impose tax on undeclared capital within a Voluntary Disclosure Procedure ("VDP").

On 14 July 2019, the Israeli District Court (the "**Court**") dismissed an application for judicial approval of a class action against the ITA, concerning the taxation, within a VDP arrangement, of undeclared capital accumulated during tax years with respect to which the statute of limitation period had already expired.

The effect, and indeed the significance of this decision is that under certain circumstances, the ITA is not bound by the statute of limitation rules when it imposes tax on unreported income, even if the tax is imposed many years after the unreported income was generated.

Background

The VDP is a non-statutory procedure introduced by the ITA in recent years. Under this procedure, taxpayers who failed to comply with Israeli tax law, can, subject to certain conditions, voluntarily declare their income and capital without facing criminal charges.

Generally, the VDP includes three main routes:

- 1) the **Regular Route**, under which the identity of the taxpayer is disclosed upon the submission of the VDP application, and which is in force until December 31 2019;
- 2) the **Anonymous Route**, under which the taxpayer can submit the VDP application on a "no-name basis" and discloses his/her identity only after the negotiations regarding the tax liability are concluded, and which expired on December 31, 2018; and
- 3) the **Expedited Route**, which is applicable to cases where the undeclared capital does not exceed NIS 2 million and the taxable income arising from such capital does not exceed NIS 500,000, and which is in force until 31 December 2019.

Taxation of the Undeclared Capital

As part of the VDP process, in addition to imposing tax on the unreported income for the relevant years covered by the VDP (usually 10 years), the ITA has developed a practice according to which it also imposes tax, usually at the rate of 10%-15%, on the opening balance of the undeclared capital which is usually referred to as the “tax on capital”.

The “tax on capital” is imposed unless the taxpayer proves that the undeclared capital is “clean”, namely that the source of the capital was not subject to tax in Israel (for example if it was generated by a non-Israeli resident outside of Israel or was granted as a gift or by way of inheritance from a foreign resident).

The claimant in the *Nukrai* case claimed that the collection of the “tax on capital”, as part of the VDP is unlawful and violates the statute of limitation rules. Accordingly, the claimant argued that the ITA should refund all taxes which were imposed on the capital.

The Court ruled that the 10-year statute of limitation period on tax offences only applies to the filing of criminal charges and does not apply to the civil tax liability. In addition, the Court stated that the rules regarding statute of limitation do not apply to taxpayers who have failed to submit tax returns or who knowingly have not disclosed all their income in the tax return. The Court concluded, that in such circumstances, when no tax return is submitted or the relevant income is not included in the tax return, there are no limitations, including any time limitation, on the ITA’s ability to issue tax assessments, provided that the request is reasonable and adheres to the principles of administrative law.

In essence, the Court’s decision in this case means that the ITA is not bound by the statute of limitation rules when imposing tax on unreported income, even if such tax is imposed many years after the unreported income was generated.

The Court also emphasised that the collection of the “tax on capital” is especially reasonable where the taxpayer who submits an application for a VDP, obtains a significant benefit, namely to be immune from criminal process. In addition, the tax rate imposed on the capital is at a reduced rate, which reflects the difficulty in proving the source of the capital.

As mentioned above, the Regular VDP Route and the Expedited VDP Route are in force only until 31 December 2019, and taxpayers for whom this procedure may be relevant are recommended to consider applying for a VDP before the deadline.

Our firm has extensive experience with hundreds of cases of voluntary disclosure, and would be happy to assist taxpayers for whom this procedure may be relevant.

Sincerely,

Herzog Fox & Neeman

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