Israel

Israel seeks introduction of a digital sales tax

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Israel's Finance Ministry and tax authority announced in the last week of April that they intend to introduce a digital sales tax (DST) that may reap some ILS 1 billion ($280 million) for the treasury. The tax authorities will be working on a tax on the local sales turnover of foreign digital companies in Israel.

The authorities are considering a 3-5% DST rate, which is similar to the tax France recently put into law.

Taxes on digital sales of foreign businesses, 2014

In 2014, Israel's High Court of Justice dismissed a private petition demanding that the tax authorities take measures forcing a value added tax (VAT) on supplies by foreign digital companies.

The court found the petition to be premature, reasoning that the new "digital world raises complex issues with wide tax implications that need to be addressed by the legislative powers". Israel's tax authorities then promised they were about to issue a professional circular regarding the taxation of internet companies.

Inventing a digital sales tax, 2016

In a long-awaited circular, Israel's tax authorities explained the conditions that would qualify the connection of a foreign digital company to the Israel marketplace as a permanent establishment (PE) in April 2016. A foreign digital seller would also be required to register as a VAT dealer, and charge and pay VAT (17%) on its supplies in Israel.

The criteria in the circular took a very aggressive approach that does not sit well with Israel's commitments under tax treaties, especially because the OECD is still mulling over the best approach to tax activities in the digital world (and whether there is a best approach at all).

On top of its incompatibilities with certain legal prescriptions, the circular also claimed effect on income from periods before the OECD's multilateral instrument (MLI) went into effect.

Not long after the publication of the 2016 circular, both the annual reports of the state comptroller and the national ombudsman objected against the writing of pseudo-tax law by the tax authorities in the form of circulars, in lieu of amendment or expansion of the applicable rules by way of a proper legislative process.

Continued evolution of taxes on digital sales in Israel

In January 2017, a proposed amendment to Israel's Tax Ordinance actually positioned 'transfer pricing (TP) principles' as the basis for taxation of digital foreign companies, abandoning the search for a deemed PE by force.

Early in 2018, eBay Marketplace Israel, eBay's local Israeli subsidiary, admitted to receiving tax assessments totaling ILS 156 million. These assessments were likely based on a claim that the local subsidiary was not merely a research and development (R&D) service supplier, but also the longer arm of the eBay group in Israel.

Other large internet companies found themselves also in discussion with the Israel tax authorities. By issuing these assessments, the Tax and Antitrust Authority made good on their promise to the 2018 special session of the Knesset Economic Affairs Committee that tax and monopoly matters in relation to foreign international digital companies that would be closely examined, and that action would be taken.

A separate proposal from 2016, seeking to levy VAT on transactions in Israel from business to consumer (B2C) by foreign 'digitals', was not supported by the Ministry of Finance.

A renewed VAT charge proposal may be tabled as well in the upcoming discussion regarding DST, unless the policymakers of Israel do not want to increase the cost of living for its consumers. On the other hand, considering services and goods of local companies are subject to VAT, then those from foreign-based providers should bear VAT as well to undo the competitive disadvantage currently experienced by domestic digital sellers.

The 2019 proposal to create and implement a DST would no longer look for solutions by way of claiming a PE or by using TP rules, but would simply tax turnover from sales in Israel of foreign digital sellers.

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