16 October 2020

Global Tax Alert

News from Transfer Pricing

Israel's Tax Authority releases draft bill to significantly amend transfer pricing rules and regulations

EY Tax News Update: Global Edition

EY's Tax News Update: Global Edition is a free, personalized email subscription service that allows you to receive EY Global Tax Alerts, newsletters, events, and thought leadership published across all areas of tax. Access more information about the tool and registration here.

Also available is our EY Global Tax Alert Library on ey.com.

Executive summary

The Israeli Tax Authority (ITA) recently published a draft bill for public consultation, proposing to amend Section 85A of the Income Tax Ordinance (ITO) and its regulations, by introducing substantial changes to the current transfer pricing (TP) reporting and documentation obligations of multinational enterprises (MNEs) in Israel. Comments may be submitted until 2 November 2020; the expected date for the final legislation is yet unknown.

The proposed legislation adopts and incorporates the principles of the OECD's Base Erosion and Profit Shifting (BEPS) Action 13, that introduced requirements for a Local File, Master File, and a Country-by-Country (CbC) report, where applicable. Accordingly, the draft bill sets rules for contemporaneous TP documentation, to be prepared annually, concurrently with the Israeli tax return, with extensive and far reaching disclosure requirements.

Multinationals with Israeli activity should carefully review the proposed legislation and consider their readiness and alignment with such potential Israeli TP requirements, in order to be better positioned in a potential audit, and to avoid penalties for noncompliance with TP rules and regulations.

Detailed discussion

The following are the main legislative amendments that are proposed to be introduced into the Israeli TP rules and regulations:

1. The new Section 85B of the ITO and regulations are introduced to stipulate TP documentation obligations that should be prepared for each international transaction until the date the Israeli tax return is submitted. This is in contrast to the current rule, that requires the taxpayer to provide the tax assessor with TP documentation only within 60 days from the request.
2. The new regulations stipulate the requirement for the preparation of a Local File and a report on the group's activities (Master File):
   - The reporting requirements in the Local File include many more details and information on the taxpayer's activity within the MNE, its business and competitive environment, the international transactions and the amounts paid or received.
   - In addition, the TP study must provide all the details and data that support the determination of the transaction price and the selected method used.
   - In addition to the Local File, the regulations set forth extended reporting requirements for the group's activities. The Master File report should include a detailed overview of the group: its growth engines; a description of the supply chain of key products and services; the group's R&D policy; a description of each entity's contribution to the value creation; information about intangible assets and the group's intercompany agreements associated with them; information on any transfer of intangibles within the group during the tax year, including the identity of the entities involved, the countries in which those intangibles are registered and the consideration paid as part of the transfer; information about financing activities of the group; consolidated financial statements of the group; disclosure of all tax rulings and preliminary approvals that were obtained by the group, and more.
3. New Section 85C would set forth the obligation of an ultimate parent entity that is a resident of Israel, whose turnover exceeds NIS 3 billion, to declare and submit a CbC report on the group and its activities in each jurisdiction.

The obligation to file applies for every tax year, within one year from the end of the tax year. This report will be submitted online by the ultimate parent entity and will be automatically shared with the tax authorities of the signatory countries to the Tax Information Exchange Agreements. The said report may also be required from companies that are not ultimate parent entities, depending on the ITA's ability to receive such information under these agreements.

Summary of major changes

The draft legislation would require:

- A taxpayer who is part of an MNE or a party to an international transaction to prepare a detailed Local File and a Master File on the MNE's global activities, on a contemporaneous basis, until the submission of its tax return in Israel.
- A taxpayer to prepare contemporaneous annual reports, according to Section 131 of the ITO, unlike the current language of the TP rules, that require according to which a taxpayer must to provide this information within 60 days, upon request.
- Significantly more information regarding its local activity and the intercompany transactions to which it is a party, and on the activity of the group of which it is a part.
- Taxpayers whose ultimate parent entity is a resident of Israel and whose global turnover exceeds NIS 3 billion to submit an online report within one year from the end of the tax year, that includes a comprehensive disclosure on all of the group's entities.

As only compliance with all of the draft legislation requirements will transfer the burden of proof from the taxpayer to the tax assessor, it in practice places a much higher burden on the taxpayer than in the current status, and anchors the ITA's position on the burden of proof as presented in tax circular 1/2020[1] in the language of the law.

Implications

The purpose of the proposed TP legislation is to enable the ITA to obtain more information on MNEs' Israeli and global operations, and to meet its obligations under international agreements to implement certain reporting obligation and share information with tax authorities worldwide.

Due to the broad implications of this proposed amendment, and the immediate impact it will have once finalized, MNEs are strongly encouraged to carefully review this draft bill to assess its impact on their TP reporting and documentation in Israel and consider necessary preparation and alignment.

Endnote

1. See EY Global Tax Alert, *Israel's Tax Authority Releases Tax Circular on Burden of Proof Related to Transfer Pricing Audits*, dated 5 June 2020.

For additional information with respect to this Alert, please contact the following:

EY Israel, Tel Aviv

- Sharon Shulman sharon.shulman@il.ey.com
- Lior Harary-Nitzan lior.harary-nitzan@il.ey.com
- Eyal Gonen eyal.gonen@il.ey.com

Ernst & Young LLP (United Sates), Israel Tax Desk, New York

- Lital Haber lital.haber1@ey.com

EY | Assurance | Tax | Transactions | Advisory

Transfer Pricing Group

EYG no. 007135-20Gbl

1508-1600216 NY
ED None

ey.com