

Your Taxes: Israel on the way to OECD membership

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For many years Israel has been interested in joining the Organization for Economic Cooperation and Development (OECD). Finally, it seems to be on the way to achieving this goal.

On May 16, 2007, the Council of the OECD resolved to open discussions with Israel, the Russian Federation, Chile, Estonia and Slovenia regarding the terms, conditions and process for their proposed accession to the OECD. And, on December 3, the OECD Council published a "Roadmap for the Accession of Israel to the OECD Convention" (not to be confused with the US President's peace roadmap).

What is so special about the OECD? The organization, which is based in Paris, defines its mission as being to help make the world economy work effectively and efficiently. It was created in 1961 as the successor to the Organization for European Economic Cooperation, which was set up in 1948 to administer the Marshall Plan for rebuilding Europe after the second world war.

The OECD's 30 current members are: Austria, Australia, Belgium, Canada, Czech Republic, Denmark, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Italy, Japan, Korea, Luxembourg, Mexico, the Netherlands, New Zealand, Norway, Poland, Portugal, Slovak Republic, Spain, Sweden, Switzerland, Turkey, the UK and the US.

In parallel to the above, OECD announced plans to engage more closely with other significant economies, notably Brazil, China, India, Indonesia and South Africa.

So Israel wants to join a club of economic heavyweights.

What are the aims of the OECD? The OECD aims to help member countries achieve sustainable economic growth and employment and rising standards of living while maintaining financial stability, thereby contributing to improved prosperity worldwide (OECD Convention 1961, Article 1).

In the pursuit of its aims, "the Members agree that they will, both individually and jointly: (a) promote the efficient use of their economic resources; (b) in the scientific and technological field, promote the development of their resources, encourage research and promote vocational training; (c) pursue policies designed to achieve economic growth and internal and external financial stability and to avoid developments which might endanger their economies or those of other countries....." (OECD Convention, Article 2)

The OECD members commit themselves to inform, consult and cooperate on the above (OECD Convention, Article 3). Therefore, the OECD's working methods are based on the principle of peer review, drawing on the experiences of member countries.

The OECD issues "Acts" - namely "Decisions" and "Recommendations" - and other "instruments" such as Ministerial Declarations (e.g. on environment or social policy) or international agreements or arrangements (e.g. on anti-bribery). Decisions are binding except for member countries that have abstained at the time of their adoption.

The position adopted by Israel in regard to the various Acts and other relevant instruments will be a crucial element of the OECD Council's assessment of whether to invite Israel to join the OECD.

What is the Israeli government's position? According to its Web site (www.oecd.gov.il): "Israel is willing and capable of supporting the OECD's instruments and participating in their formation and implementation. Israel has carried out far reaching economic reforms based on the OECD's recommendations with respect to taxes, labor, competition, capital markets, pension funds, infrastructures, communications, and transport."

What does the OECD Roadmap require from Israel? The OECD Deputy Secretary-General Thelma Askey and other OECD committee officials will visit Israel in the period up to mid-March 2008 to set the accession talks in motion.

For example, the Investment Committee will review the principles of non-discrimination and transparency and effective enforcement of intellectual property rights in Israel, among other things.

The Committee on Financial Markets will want to see a relaxation of restrictions on cross-border banking and other financial services.

The Steering Group on Corporate Governance will want to ensure there is a consistent regulatory framework for the enforcement of shareholder rights and the equitable treatment of minority and foreign shareholders.

The Insurance and Private Pensions Committee will want to see a relaxation of restrictions on cross-border insurance and pension services.

The Environmental Policy Committee will want to ensure that the generation of hazardous and other waste in Israel is reduced.

On the tax front, the Committee on Fiscal Affairs will want a commitment from Israel on various core tax principles.

The first core principle is eliminating international double-taxation on income and capital through complying with the key substantive conditions of the OECD Model Tax Convention. On the whole, Israeli tax officials do refer to this Convention and its accompanying commentary. Also notable is the OECD Council's Recommendation Concerning Tax Treaty Override of October 2, 1989, against legislation that is intended to have effects in clear contradiction to international treaty obligations.

A second core tax principle is applying the OECD's transfer pricing guidelines to transactions between related parties. Israel has recently introduced its own transfer pricing regulations but severe uncertainties remain regarding no-interest loan notes, among other things.

A third core tax principle that Israel will no doubt embrace concerns engaging in effective exchange of information regarding taxpayers.

A fourth core tax principle is that of combating harmful tax practices in accordance with the 1998 OECD Council Recommendation and related reports. It will be interesting to know whether Israel's popular tax breaks for privileged enterprises, approved enterprises and approved properties will prove acceptable to the OECD.

A fifth core tax principle is eliminating double and unintentional non-taxation through the development and implementation of International VAT Guidelines designed to encourage greater coherence and clarity for international transactions. Israel's zero rate VAT conditions for exported services are harsher than those found in the EU. It remains to be seen what will be the OECD's reaction

To sum up, if Israel succeeds in joining the OECD, this will not change its legislation overnight. The OECD is not the EU. Instead OECD membership would show everyone that Israel's economic and fiscal policies are now in line with internationally accepted norms. This would be a symbolic prize for two decades of painful reform and provide a forum for sharing Israeli insights with other countries. And the Israeli Tax Authority may be constrained from taking an extreme stance on tax matters.

As always, consult experienced tax advisers in each country at an early stage in specific cases.

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