Supermodel's Tax Fight Helps Prompt Israel to Redefine Residency

Israeli tax authorities warned supermodel Bar Refaeli and her parents they may be charged with tax evasion. Refaeli is shown here at an October event in Madrid.
Photograph: Pablo Cuadra/Getty Images

- Objective definition needed as more wealthy individuals reside and invest abroad
- Proposed changes could be adopted as early as next year, official says

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Israeli tax authorities are planning to tighten the definition of a resident for tax purposes, partly to avoid costly court battles such as the one involving supermodel Bar Refaeli.

The current criteria for residency, last amended in 2003, are open to broad interpretation, according to tax authorities.

Roland Am-Shalem, senior deputy director general of the tax authority, told Bloomberg Tax Feb. 6 that a committee is "examining a more objective definition with simpler criteria in order to create greater certainty."

The committee will consult with practitioners and present proposals to the tax commissioner "within months," Am-Shalem said. Once approved, they will form the basis of draft legislation for the Knesset parliament. Depending on the political process, the first amendments could be adopted by 2020, he said.

A clearer, more objective definition will sharply reduce the number of disputes as the modern economy creates increasing numbers of high-net-worth individuals who reside, work, and invest in several countries concurrently, Am-Shalem said.

The Israeli state prosecutor warned Refaeli and her parents Jan. 3 that they could be charged with tax evasion and money laundering, as well as using foreign accounts and corporations to conceal income earned abroad totaling more than 23 million shekels ($6.33 million).

The supermodel told local authorities she wasn't an Israeli resident, but in tax returns to authorities in the U.S.—where she was mostly living with Hollywood actor Leonardo DiCaprio—she claimed to be a non-U.S. resident on the basis that she lived in Israel, according to the justice ministry.

'Center of Life'

Israel's tax code determines residency based on a number of factors, including the number of days spent in the country during a one-year or three-year period, and the location of the taxpayer's family, business, and residence. None of these factors are deemed to concretely decide residency for tax purposes, which is determined by whether the taxpayer's "center of life" is in Israel.

"The fundamental test of the taxpayer's 'center of life' is somewhat subjective, which creates a great deal of uncertainty in many cases, and arguments arising from that uncertainty between the taxpayer and the tax authority," Am-Shalem said.

Am Shalem didn't reveal the number of people who might be affected, or the amounts of tax involved, but said the authority wouldn't be considering the matter unless the numbers were significant.

"We wouldn't amend the legislation just for a few isolated cases. This isn't an amendment that aims to raise more taxes. It's an amendment that's trying to create order," he said. "It may end up raising less. We're not trying to add more income to the treasury. We're trying to increase certainty."

The authority is looking at a range of models from other countries and the end result will most likely be a fusion of regulations from several jurisdictions, he said.

Need for Change

Change is needed because the different residency criteria aren't formally weighted and can be unfair, said Daniel Paserman, partner and head of tax at Gornitzky & Co. law firm in Tel Aviv.

"It's not that someone who fulfills certain conditions is by definition a tax resident, or if you don't fulfill certain conditions then you aren't. It's still very much a matter of interpretation to be applied in each case," Paserman said by phone Feb. 6. "This results in a lot of discussions and a lot of disputes around this issue with the tax authority. The feeling from both sides is that it's not really clear."

The basic measure is whether a taxpayer has spent 183 days in Israel in a single year, or 425 days over three consecutive years. This by itself isn't a determining factor and can be rebutted by either the taxpayer or the authority, Paserman said.

Individuals who gradually reduce their presence in Israel over three years might still be deemed tax residents by the authorities even though they spent less than 183 days in the country in each of those years and had moved their home, family, and employment abroad at the start of the period, he said.

High Earners Most Likely Affected

The people most likely to be affected are high earners. "You see a lot of issues around tax residency with people that work abroad or have assets abroad or emigrated. In many cases there are high-net-worth individuals, so the sums at stake are relatively high in Israeli terms. They are looking at people with big sums. It's probably a few hundred and these are the high net worth individuals who, if they were to pay taxes in Israel, the amounts would be relatively substantial," Paserman said.

The amendment now under consideration "will give certainty, which is a very important virtue in tax," said Boaz Feinberg, partner and head of the Tax and Financial Regulation Department at Zysman, Aharoni, Gayer and Co. law firm in Tel Aviv.

"If you had a specific rule about what constitutes an Israeli resident, there will be less wiggle room to claim that your center of life is not in Israel," Feinberg said by phone Feb. 6.

Multinational corporations employing executives affected by the changes will have to examine their system of remuneration and tax deductions to ensure they comply with the changes when they take effect, he said.

The authority will also have to consider how the amendments will affect "double-taxation treaties we may have with other countries that relate to the manner in which other countries determine residency," Feinberg added.

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