



Report of the State comptroller of Israel | January 2024

Israel Tax Authority

Management of the Investigations Array at the Tax Authority



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Background

The Income Tax Ordinance [New Version], 1961 (the Income Tax Ordinance), and other tax laws, such as the Value Added Tax Law, 1975, set penalties for those committing tax offenses, including severe criminal penalties to discourage tax evasion.

The Israel Tax Authority (the Tax Authority) divides tax offenses into basic offenses and material (substantial) offenses. The basic offenses are infractions and misdemeanors, which can also result from the taxpayer's negligence without criminal intent behind them. On the other hand, the material offenses are acts or omissions committed with deliberate intent. They may include fraud, trickery, and deception, and they are serious offenses that reach the level of a felony.

For example, Section 220 of the Income Tax Ordinance deals with fraudulent acts committed intentionally to evade tax or help another person to evade tax. Tax assessors investigators (also the investigation units) are in charge of launching and executing the criminal handling of taxpayers. Tax assessor investigators is an official with criminal investigation powers authorized by the Director of the Tax Authority and by the minister in charge of the Police to exercise a police officer's powers regarding investigations, collection of evidence and its recording, searches, and seizure of documents.



Key Figures

22% of the GDP, at USD 488.5 billion in 2021

the extent of the black economy¹ in Israel, according to a World Bank study from 2010

936 and 567 investigations

conducted by the Income Tax, the Customs, and VAT Department (respectively) in 2019–2021. Only 166 (17.7%) and 68 (12%) of these cases were completed, and the rest are still in a state of investigation or filing an indictment

453 investigations

were launched against suspects in 2012–2021, and no indictment has yet been filed in respect thereof

in 79% of financial service providers (changes)

examined in 2022 as part of combating crime and violence in Arab society, deficiencies were found (in 37 out of 47 financial service providers examined)

20 investigators

investigators in the Tax Assessor Investigations Office in Jerusalem, responsible for the largest geographical area in Israel, with 347,897 taxpayers as of 2022

for 13%

of the taxpayers investigated by investigating tax assessment offices and ended in a sentence, no assessments were determined by the assessment offices

21%

of the cases investigated in 2019–2021 were for less than NIS one million. 34% of the cases above were between NIS 1–3 million, and 45% were over NIS 3 million


only 15 investigations

in virtual currencies in three years, compared to the number of Israelis who trade in them – 200,000 Israelis, according to the Chief Economist's report



¹ Black economy is economic activity that is not reported, and for which no tax is paid. The resulting income therefrom is called "black capital".



Audit Actions

 From September 2022 to February 2023, the State Comptroller's Office audited the Tax Authority's activities in investigations. The audit was conducted at the Tax Authority's management, the Income Tax regional offices, and the VAT investigation units. Additionally, completion examinations were carried out in the Customs and VAT Legal Department and the State Attorney's Office.

Key Findings

-  **The Workforce Standard in the Tax Investigation Offices** – the Tax Authority failed to establish the necessary workforce standards for the investigation units based on their scope and quality. For example, as of the end of 2022, the Tax Investigations Office in Jerusalem had the lowest number of investigators (20) among all the investigation offices despite being responsible for criminal investigations of taxpayers in the largest geographical area in the country, including southern Israel, with the most significant number of taxpayers (347,897) and even though the Israel Police have designated this area as a target for increased handling as part of combating crime. It was further raised that the Tax Authority did not set the number of investigators according to the specific needs or characteristics of each assessment office, such as office size, the geographic area it is responsible for, the resident and taxpayer population, and the compliance level of the taxpayers with relevant tax laws. The audit found that each investigator handled about five income tax investigation cases per year.
-  **Intelligence Work for Opening Investigation Cases** – the audit raised that only 12% of the investigation cases (14 out of 112) opened by the tax investigations offices in 2019–2021 were based on information obtained from their intelligence units. The Income Tax intelligence units lack a method for collecting and evaluating information; There is no definition for forming an intelligence picture; There is no cooperation between the intelligence units and the assessment offices to obtain information on assessments; There are no suitable computerized information infrastructures, and there is no access to other intelligence information within the Tax Authority. Moreover, the audit found that in the Income Tax Division's tax investigations offices, only three employees were designated in each office to gather information from various open sources, and they did not analyze the information. These may potentially compromise the existing intelligence picture concerning cases of income tax offenses.



- Setting of Investigation Goals** – the audit raised that in three years, 2019–2021, the Tax Authority launched about 1,500 investigations. About 16% of these cases were resolved within that timeframe. The remaining cases (84%) are still being handled, either in the investigative units, the State Attorney's Office, or the Customs and VAT Legal Department. The Tax Authority did not set specific goals for its investigation units according to the existing risks in the areas entrusted to each unit. Consequently, the Tax Authority management and the investigations headquarter do not prioritize cases for the investigation units based on risk and tax evasion assessment analysis, hindering coordination and cooperation with other investigation units within the Authority and preventing the possibility of maintaining force multipliers for orderly and targeted work regarding investigation targets suspected of committing tax offenses. The audit found that about half of the investigated cases involved taxpayers suspected of tax offenses of over NIS three million, one-third were suspected of offenses ranging from NIS one million to three million, and around 21% of the cases involved less than NIS one million.
- Limitation of the Duration of Investigations** – in January 2019, the Knesset Plenum approved Amendment No. 87 to the Criminal Procedure Law [Consolidated Version], 1982, setting the maximum duration of investigation procedures and handling cases until an indictment is filed. Accordingly, it was set in Tax authority procedure that suspects will be investigated for one to four years depending on the seriousness of the crime. In 2019–2021, 936 and 567 investigations were conducted by the Income Tax and Customs and VAT Division, respectively. Only 166 (17.7%) and 68 (12%) of these cases, respectively, reached closure, while the rest are either under investigation or prepared for an indictment. It was found that the Tax Authority lacks organized monitoring and control processes for the duration of the processing of investigation cases, making it impossible to ascertain, based on the data in the computerized system, the processing status of the cases against the established statutes of limitations and the number of cases closed due to the statute of limitations.
- Scope of Investigations in Virtual Currencies** – it was raised that the 'Yahalom' Unit handled about 15 investigation cases on this subject. As of February 2023, most of these investigations are under review by the State Attorney's Office in preparation for indictments. The handling of about 15 cases, compared to an estimate of 200,000 Israelis owning digital assets as of November 2022 (according to the chief economist report), indicates a considerably low scope of investigations in a field with a high risk of tax evasion.
- Integrated Intelligence Center** – the Israel Police, the Tax Authority, and the Money Laundering Prohibition Authority – in March 2007, an integrated intelligence center was established to improve intelligence activities in criminal organizations. The Center brings together police officers, representatives of the Tax Authority, and the Money Laundering Prohibition Authority as regular participants, with the participation of additional authorities, such as the State Attorney's Office, invited as required. The Intelligence



Center annually distributes a notice to the regular participants, asking them to indicate targets (criminals) on which the Center will be asked to provide intelligence information. Since its establishment, the Income Tax investigation units have not approached the Center for information on targets owing taxes or which they wish to investigate.


Legal Handling of Investigation Cases – following the Attorney General's instructions from August 2010², which were subsequently anchored in legislation, an indictment for infractions should be filed within six months, within 12 months for misdemeanor offenses, within 18 months for felonies punishable by up to ten years in prison, and within 24 months for felonies punishable by over ten years' imprisonment. Most of the income tax cases that are transferred to the state attorney's office is of felony offenses punishable by up to ten years in prison, for which, as mentioned, an indictment must be filed within 18 months. The audit found that in 38% of the reviewed cases (111 out of 289) transferred from the Income Tax investigation units to the State Attorney's Office in 2017–2021, the time between transfer to the prosecution and the filing of an indictment exceeded the Attorney General's instructions, which stipulated a time frame of 18 months and, at times, even extended to about four years.

Closure of Cases from Joint Investigation Teams by the State Attorney's Office – an agreement between the Director of the Tax Authority and the State Attorney from July 2016 regarding the division of work between criminal prosecution at the Tax Authority and the state attorney's Office determined that in cases involving joint investigation teams of multiple investigative agencies, "all of the joint investigation team's satellite cases will be handled by the entity handling the primary joint investigation team case." It was found that despite this agreement, the state attorney's Office, from the outset, only handled the primary cases of the joint investigation teams, while the satellite cases were not addressed. For example, the state attorney's Office handled an investigation case concluded in 2019 with respect to only nine suspects, while 47 suspects (satellite cases) involving hundreds of millions of NIS were not handled.

Closure of Cases from Joint Investigation Teams by the VAT Legal Department – some investigations raise suspicions of committing offenses in income tax and VAT fields. In most of them, the Customs and VAT Legal Department handles the filing of indictments. It was found that when the Customs and VAT Legal Department decides to close a case in which a joint investigation of the Tax Authority and VAT was carried out, it reports it only to the VAT investigation unit and not to the Income Tax investigations offices. In such a case, the Income tax investigations offices are prevented from examining the decision and appealing it when necessary.

² This instruction has been updated several times, with the last update being made in April 2023. According to the instruction, in exceptional cases, the relevant authorities can extend the time limit for the legal handling of the case.









 **The Interrelationship Between the Tax Investigations Offices and the Tax Assessors** – the audit found that in only 75 of the 86 cases examined (87%), the assessment offices determined assessments for tax offenders for whom a sentence was issued. In 11 cases (13%), they did not determine assessments until the end of the audit. This is not according to the instructions of the Tax Authority, by which assessments must be determined as soon as possible in all cases where taxpayers have been caught in tax evasion and tax offenses. It should be noted that these are tax offenses in hundreds of thousands of NIS and up to several million NIS in each case.



Promoting the Fight Against Crime and Violence in the Arab Society – the State Comptroller's Office commends the Tax Authority's activities in Operation "Safe Path" for increasing governance and enforcement of tax laws as part of the fight against crime in the Arab sector. The Tax Authority carried out tax collection activities and improved governance in various areas, such as enforcement, bookkeeping audits, VAT audits, audits of financial service providers (money changers), and joint activities with the Israel Police against criminal organizations. Significant deficiencies have been found in the conduct of financial service providers concerning bookkeeping; Deficiencies were found in the conduct of 79% (37) of the financial service providers examined. Furthermore, deficiencies were found in 69% (573) of the bookkeeping audits that were conducted (821 audits), 309 (37%) of them regarding failure to record receipts.

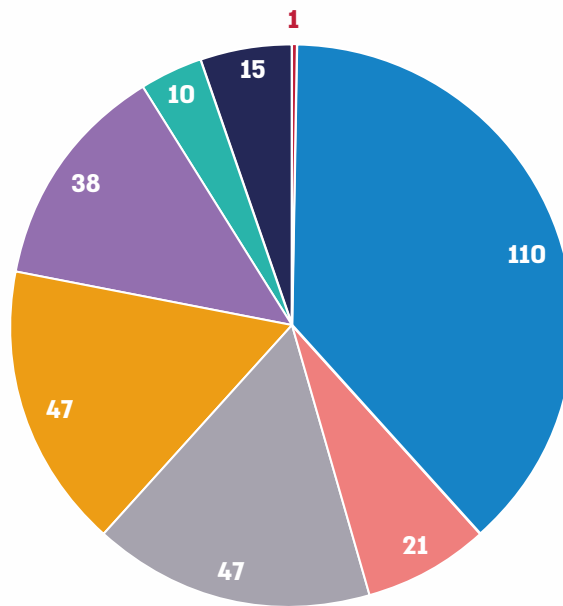


Key Recommendations

-  It is recommended that the Tax Authority examine the goals it has set and the tasks assigned to the Income Tax and the Customs and VAT tax investigations offices in the various regions, determine the number of positions required for each investigation office according to relevant indicators, and staff them.
-  It is recommended that the Tax Authority gather information on the handing times of cases and regularly monitor it. It should cooperate with the state attorney's office to file indictments according to the law. Moreover, it should implement a computerized system enabling the management of the tax assessment units and of the Tax Authority to follow-up on investigations to regularly review the schedules and progress in them.
-  It is recommended that the Tax Authority establish in each of the intelligence units in the investigation offices an array that can analyze, evaluate, and enrich the information in its possession, including computerized tools that can turn the information therein into valuable information and assist in locating taxpayers concealing income and evading paying taxes.
-  The Authority should collect data on the processing times of the cases and regularly monitor the subject. It is further recommended that the Tax Authority be in regular contact with the State Attorney's Office and insist on submitting indictments on time and according to the requirements of the law.
-  The Tax Authority management should regulate the cooperation between the Customs and VAT Legal Department and the Income Tax investigation units and ensure full sharing of information, including when deciding to close a case, so the Income Tax decides upon the continued handling of the cases.
-  The Tax Authority should maintain ongoing monitoring of the cases that the tax investigations offices transfer to the assessment offices and ensure that they determine appropriate tax assessments while making full use of the information transferred to them and fully exploit the information until the tax debts owed are collected.



The Duration of the Legal Processing of the Investigation Cases According to the Number of Cases from the Stage of Launching the Investigation to the Filing of an Indictment on a Tax Offense, 2017–2021



- Up to 18 months
- Up to 1 year
- Over 4 years
- Up to 2 years
- Up to 3 years
- Up to 2½ years
- Up to 6 months
- Up to 4 years

According to the Tax Authority figures, processed by the Office of the State Comptroller.



Summary

The criminal handling of taxpayers suspected of evading income tax is of great importance since, in addition to punishing the delinquent taxpayers, it deters the entire taxpayer public. The deterrence is essential in operating an efficient and fair tax system.

In this report, deficiencies were noted regarding the workforce headcount standard of the investigation units, the duration of the investigation, the intelligence work, and the legal handling of the investigation cases.

It is recommended that the Tax Authority rectify the report's deficiencies to strengthen the system of investigations, increase deterrence, collect real tax, and strengthen the fight against economic crime.

