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Israel

Israeli Tax Proposals for Blockchain First Steps to Approval



By Matthew Kalman

A draft circular on blockchain initial coin offering (ICOs) from the Israel Tax Authority is the first step toward legitimacy for a new industry still shunned by Israeli banks and treated ambiguously by the Israel Securities Authority, according to a tax expert who advised in its drafting.

"Until now, companies in Israel didn't know how to treat an ICO from an accounting and tax standpoint," said Yitzchak Chikorel, partner and head of international taxation at Deloitte in Tel Aviv, who advised the authority on the wording of the Jan. 17 circular.

By identifying three categories of blockchain investment—cryptocurrencies like bitcoin; security tokens; and utility tokens—and proposing the tax treatment for each, the authority has made a "big statement" that raising capital through a "token generation event," as he prefers to call an ICO, "is a legitimate business," Chikorel told Bloomberg Tax Jan. 24.

Revised Treatment, Delaying Tax Event

Even though Israeli-based companies have been at the forefront of blockchain offerings—including Sirin Labs, which raised \$157 million in December, and Bancor, which raised \$153 million in just a few hours last June—almost all of them operate and hold their ICOs outside the country. A draft tax authority circular on Bitcoin and other virtual currencies published in January 2017 classified them as assets, imposing capital gains on all trading and creating a major obstacle to the development of the industry.

The revised treatment of utility tokens represents a shift that could allow the cryptocurrency industry to flourish in Israel. "The companies now have some sort of clarity how the tax authority will view the ICO, which is very important. Up until now it's been like gambling," Chikorel said.

The key change in the new circular is to propose separate tax treatment for a blockchain "utility token," issued by a company in return for the purchase of a future service or product. Companies would record the revenue but delay the tax event until the service or product is supplied.

"The first circular was not really in favor of doing the ICO in Israel," said Vered Meller, tax partner at Shibolet and Co. law firm in Tel Aviv who has several clients planning ICOs. "They didn't want to recognize the tokens or virtual coins or any currencies and they classified it as an asset for Israeli tax purposes."

"It's a slight shift. It's not really clear which utility tokens will be allowed to do the ICO here in Israel," Meller told Bloomberg Tax Jan. 24, "In my view, in each case we'll have to go into a ruling with the tax authority because I can't see a company doing their ICO in Israel without receiving prior written approval."

"The shift is only with regard to companies who have a product that can be used after the ICO and the tokens are usable," she said. Even then, the circular says that tokens offered to employees will be treated as income rather than similar to stock options, she added.

Banks Unhelpful on ICOs

The suggested change in tax policy will not be enough to persuade companies to launch their blockchain offerings in Israel, she warned. "We have a problem with the banks," she said. "The banks don't want to open accounts for companies who are doing blockchain technology, or even for service providers. If you want to encourage the ICOs then you have to have the entire regulation in order—securities, the banking system and everybody who will have to recognize that you can do the token generation event in Israel and transfer the money into your account."

Although the new draft softens the approach to utility tokens, these make up only a small proportion of cryptocurrency offerings, said Ayelet Hillel-Birenszig, senior tax partner at Shekel and Co. law firm in Tel Aviv.

"While the draft provides more certainty to issuers, more work needs to be done, since the future of Blockchain is versatile tokens that entail the characteristics of what is referred to in the draft as 'distributed tokens' like Bitcoin

Snapshot

- Israel is blockchain hub but companies take ICOs abroad
- Draft circular gives legitimacy to companies shunned by banks, securities authority

and Ethereum, and 'security tokens' that represent capital rights. If the ITA wishes to encourage ICOs in Israel, one should consider certain beneficial tax breaks, as done for example with respect to technological income," Hillel-Birenzwig said in a Jan. 19 email.

Tax Authority 'Closing Their Eyes'

Classifying bitcoin as an asset means the tax authority is "closing their eyes" to reality, said Harel Perlmutter, partner at Barnea and Co. law firm in Tel Aviv.

"I understand why the tax authority went with an asset because it will bring in more taxes than if we classify it as a currency," Perlmutter said by phone on Jan. 21. "There are hundreds of thousands of businesses all over the world accepting bitcoin as a regular currency. There is legal reality and real reality," he said, adding that the tax authority's hands were tied by legislation half a century old. "The legislators have to sit and legislate. This is a new era," he said.

The tax authority is now taking comments on the draft, and the final circular could be issued as early as next month, Chikorel said. Meanwhile, a committee from the Israel Securities Authority, which recently placed tight restrictions on exchange trading in cryptocurrency companies, is due to report soon on a regulatory framework for ICOs.

. "I hope it won't take long," Chikorel said. "It just causes pain, problems, headaches and loss of money to the companies and to the Israeli economy."

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