Customs & Trade in Israel

A Legal Newsletter

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Lifting the Corporate Veil for the Collection of Import Duties

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Background:

The Tax Authority, as an administrative authority, has an array of enforcement tools at its disposal for the collection of tax deficits. Among others, the Tax Authority may (under certain circumstances) impose foreclosures, delay the release of import shipments, impose fines if a debt is not paid on time, and more.

One of the tools the Tax Authority is empowered to perform (under the proper circumstances) is piercing the corporate veil, when an alleged tax evasion was performed by concealing or selling assets at no cost to a related company. Such situations occur, for example, when a certain company halts its activity as it nears a taxation point, and another company, the "same old Bess in a new dress", continues its activity.

This power is granted to the Tax Authority under Section 106 of the Value Added Tax Law in relation to VAT, and through references in other laws to custom duties and purchase tax as well.

In short, Section 106 states (among others) that:

> **"If the person liable to tax has a final debt and he transfers his assets without consideration or transfers them to a person with whom he has a special relationship for no consideration or for partial consideration, without having any assets left in Israel for payment of the debt (hereafter: the transferor), then the final debt may be collected – (1) if the transferor is a body of persons – from whoever received the assets from that body of persons under the said circumstances;"**

In this situation, if the conditions specified in the law are met, the Tax Authority may demand the payment of the tax from the "inheritor" of the original debt. The new company may contest the decision in court, if it so wishes. It should be noted that this is not a piercing the corporate veil in the classical, corporate law sense - the collection of a debt from a shareholder. Rather, the Tax Authority may collect the debt of one corporation from a different corporation.

In an April 2018 ruling, the Supreme Court rejected the appeal of a company which was the alleged "inheritor" of the company with the original debt, and ruled that the Tax Authority acted lawfully in demanding the tax debt from it.

Case Facts:

SIF Metals Ltd. (established 2006) and the Elshurok Metalwork Shop Ltd. (established 2002) were active in the iron for construction field. A certain individual managed both companies as the owner of SIF Metals and co-owner (owning half the shares) of Elshurok Metalwork, alongside his brother.

In 2008, the individual was questioned by VAT authorities on suspicion of offsetting VAT inputs illegally. In 2010, an 18 million ILS VAT assessment was issued for Elshurok Metalwork.

In 2011, following a court appeal by Elshurok Metalwork, the parties reached an agreement for payment of the debt in installments. After Elshurok Metalwork failed to meet its payments, the immediate payment of all outstanding debt was demanded.

Why Did the Tax Authority Decide to lift the Corporate Veil? What was the Company's Response?

In 2013, the Tax Authority announced that following an investigation it conducted, it now sees SIF Metals as the "inheritor" of Elshurok Metalwork and its debt, as assets and commercial activity of Elshurok Metalwork were transferred to SIF Metals for no consideration or for partial consideration, and the companies have a special relationship. The Tax Authority therefore demanded payment of the tax debt from SIF Metals.

SIF Metals appealed to the court, an appeal which was rejected by the District Court. Among others, the company argued that piercing of the corporate veil can be performed only when the final tax debt existed prior to the transfer of activity. In cases where the transfer of activity occurred prior to the final tax debt, the tax authorities may not implement this tool.

In addition, the company argued that the VAT authorities power to lift the corporate veil is limited to cases in which the assets were allegedly concealed, whereas in this case the transferred activity was for partial consideration (if it was transferred).

The Supreme Court's Ruling:

The Supreme Court adopted the District Court's ruling, stating that the tax authorities may implement the piercing of the corporate veil tool even when the transfer of activity between the companies was prior to the final tax debt. In this regard, the court added that the date of the final tax debt is also in the hands of the taxpayer, as he may appeal the assessment, appeals which at times are found to be baseless appeals.

Furthermore, the court ruled that if the appealing party's arguments are accepted, any taxpayer investigated by the tax authorities, who may assume he will soon face a tax debt, may conceal his assets prior to the issuance of a final tax debt, thus undermining the enforcement and collection powers of the Tax Authority.

In addition, on a procedural level, the court ruled that when the Tax Authority pierces the corporate veil and seeks to collect the debt of one company from another, the burden of proof rests upon the taxpayer, which must prove he did not conceal his assets.

As for the appeal itself, the Supreme Court ruled that there is no cause to intervene in the District Court's ruling that the assets were indeed concealed, justifying a piercing of the corporate veil. The company's arguments regarding the value of the activity transferred were not proven, and the court rejected the appeal.

What did the Courts Rule in Similar Cases?

A. In 2006 the court ruled regarding a case in which the Customs Authority demanded a retroactive customs deficit due to the invalidation of EU certificates of origin for children clothes. The importing company faced financial difficulties in 2002, and a new company began operating that year, signing a new franchisee agreement with the supplier and lease agreement with the store owner, inheriting the activity of the original company.

It was not until 2004 that the Customs Authority demanded the tax deficit to invalidating the certificates of origin, and as the original company faced financial difficulties, the Customs Authority demanded payment of the tax deficit from the new company. The new company argued in court that Section 106 of the Value Added Tax Law may only be implemented when the transfer of assets or activity for no consideration or to a company with a special relationship is done after the final tax debt is set. In this case, the company argued, there was no transfer of assets, and even if there was, it was performed in 2002, while the final tax debt was issued only in 2004 with the issuance of the tax deficit. The court accepted the company's argument and ruled that the tax deficit notice was issued unlawfully.

The new company was represented by our firm.

B. in 2014, the Customs Authority argued that it is within its power to collect custom duties and purchase tax owed by a company suspected of lowering the import price from an "inheritor" company. The court balanced the interests of both sides, ruling that only half of the debt may be collected by piercing the corporate veil, while the rest will be guaranteed by other guarantees. Among others, the court stated that a piercing the corporate veil may be performed even when the debt is contested, as long as it may be collected under the Tax Ordinance (Collection).

C. in 2014, the Supreme Court ruled that prior to the legislation of Section 106 to the Value Added Tax Law, the Tax Authority was not authorized to pierce the corporate veil in order to collect a tax debt. Rather, the Tax Authority should have approached the court as a plaintiff, submit a claim against the taxpayer and request that the court pierce the corporate veil.

The above review is a summary. The information presented is for informative purposes only, and does not constitute legal advice.

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