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Israel

Tax

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This country-specific Q&A provides an overview of tax laws and regulations applicable in Israel.

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Israel: Tax

1. How often is tax law amended and what is the process?

Tax laws in Israel are constantly amended in order to implement various policy decisions (e.g., granting incentives) as well as aligning the tax system to the ongoing challenges and changes in the global tax arena.

To amend an existing tax law (or to adopt a new law), the Israeli Knesset (Israel's parliament) generally needs to enact the amending or new law by a majority vote. Certain matters are dealt with through regulations, which are promulgated based on statutory grants of authority.

2. What are the principal administrative obligations of a taxpayer, i.e. regarding the filing of tax returns and the maintenance of records?

Following its incorporation and upon commencement of operations in Israel, a corporate entity must register with the Israel Tax Authority (the "ITA") and open income tax; value added tax ("VAT") and withholding tax files as well as a file with the National Insurance Institute (the "NII").

Taxpayers are required to file income tax returns annually and include a self-assessment of the tax liability. Absent extensions that may be applicable or granted, the tax return filing deadline is five months following the end of the tax year for which the tax return is filed. Audited financial statements and a tax–accounting reconciliation report are generally required to be submitted with the annual tax return. In addition, certain monthly reports are required to be filed with respect to income tax advances, VAT, withholding taxes, and National Insurance.

Taxpayers are required to retain documentation until the later of seven years from the end of the tax year for which such documents relate or six years from the submission date of the tax return.

3. Who are the key tax authorities? How do they engage with taxpayers and how are tax issues resolved?

The ITA is the main regulatory authority with respect to taxes in Israel, consisting of two main units, income tax and VAT. The NII is the state institution responsible for the regulation and collection of social security payments in Israel.

Resolution of matters with the ITA generally depends on the complexity of the issues at stake but can range from a few weeks to over a year, not including legal appeal procedures.

4. Are tax disputes heard by a court, tribunal or body independent of the tax authority? How long do such proceedings generally take?

Yes. The ITA may audit a tax return and issue its own tax assessment. Generally, a taxpayer may dispute a tax assessment by a written notice of objection to the assessing officer requesting additional review and change of the assessment. The written objection should be submitted within 30 days after the tax assessment is served to the taxpayer and must clearly state the grounds of the objection. The assessing officer who prepared the assessment does not hear the objection, but rather, it is heard by a second officer in the same local office. The decision of the second officer is subject to appeal to the District Court, which decision may then be appealed to the Supreme Court.

It should be noted that the ITA serves as Israel's competent authority with respect to mutual agreement procedures applicable under Israel's double tax treaties.

Depending on the specific dispute, it may take up to a few years to obtain a final resolution.

5. What are the typical deadlines for the payment of taxes? Do special rules apply to disputed amounts of tax?

Taxpayers are generally required to make monthly advance payments of corporate taxes (typically calculated as a percentage of the taxpayer's turnover) throughout the tax year, on account of the annual tax liability, and to pay any balance shown on the tax return when submitted.

If a taxpayer appeals an assessment to the District Court and pending its ruling, tax amounts under dispute (including interest and indexing payments thereon) are suspended.

Payment of VAT is made on a periodic basis with submission of a periodic VAT return (filed on a monthly basis if a certain turnover threshold is exceeded, and if not, bi-monthly). Similar treatment with respect to payment of disputed VAT amounts applies.

6. Are tax authorities subject to a duty of confidentiality in respect of taxpayer data?

The ITA is under a statutory duty to keep taxpayers' information confidential, a breach of which may trigger criminal offences. Exceptions apply with respect to disclosure of such information to the NII or in certain bankruptcy procedures.

7. Is this jurisdiction a signatory (or does it propose to become a signatory) to the Common Reporting Standard? Does it maintain (or intend to maintain) a public register of beneficial ownership?

Similar to other countries, Israel has committed to implementing automatic exchange of information under the OECD Common Reporting Standard ("CRS") and the US Foreign Account Tax Compliance Act ("FATCA"). Under both the CRS and FATCA, the ITA obtains financial information from Israeli financial institutions pertaining to financial accounts of non-Israeli residents and exchanges such information with partner jurisdictions on an automatic and annual basis. Domestic legislation and regulations have been adopted to facilitate compliance with said exchange of information obligations.

There is no public register of beneficial ownership.

8. What are the tests for determining residence of business entities (including transparent entities)?

Under Israeli domestic law, entities are generally deemed residents of Israel for tax purposes if they are either (i) incorporated in Israel, or (ii) managed and controlled from within Israel (disregarding the place of incorporation). The management and control test is a facts and circumstances test, determined based on the location whereby strategic decisions pertaining to the entity are made.

The ITA's interpretation of management and control is relatively broad and is not limited, for example, to the location of board meetings. A more substantive examination is conducted which considers the locations where the need for decisions arose, the decisions were deliberated, alternatives were considered, preparatory work for the implementation of such decisions was performed, consultations with professionals were made, and the location where the decision was finally shaped and crystallised. The place where the board of directors holds its meeting is an important factor, although not determinative.

9. Do tax authorities in this jurisdiction target cross border transactions within an international group? If so, how?

Yes. One of the fields the ITA has been focusing on in cross-border transactions relates to group restructurings and implementation of changes to business models, most commonly following an acquisition of an Israeli target company. The ITA published a comprehensive circular number 15/2018 (the "Circular"), addressing the Israeli income tax aspects of business model restructuring by multinational groups. A change of a business model refers mainly to circumstances under which functions, assets or risks (so called "FAR") of an entity are transferred or terminated. This matter is commonly raised in tax audits of Israeli companies that are acquired by multinational groups, and following the closing of the acquisition, the intellectual property of the Israeli acquired company is transferred, or deemed transferred, to a non-Israeli affiliate, or the entrepreneurial aspects of the acquired company (such as sales functions) are terminated. The Circular addresses two major aspects of a business model change: (a) the identification and characterisation of such change in the business model; and (b) valuation concepts and methodologies of the FAR transferred in the course of such business model change. The Circular states that it follows the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations from 2017 (the "OECD Guidelines"). We should note that the Circular represents the ITA's interpretation of the law and accordingly, its position on said matters. The Circular does not, however, have any legal binding status and therefore, courts are not bound by it.

The ITA will typically examine whether such restructurings, the impact of which may reduce taxable profits in Israel, have a business purpose and legitimate and economic substance beside the main purpose of tax avoidance. A particular area of focus is the appropriate transfer price of intellectual property of newly acquired Israeli companies that is transferred to its non-Israeli affiliates post-acquisition.

In addition, the ITA tends to carefully examine claims for reduced rates of withholding based on double tax treaties and is sensitive to treaty shopping. Prior to determining eligibility for treaty benefits with respect to related party cross-border transactions (such as reduced rates on royalty or interest payments), the ITA will check if the entity claiming relief is resident both "legally and factually" in the treaty country and the is the beneficial owner of the income. In conducting the examination, the ITA applies general beneficial ownership and "economic substance" doctrines.

10. Is there a controlled foreign corporation (CFC) regime or equivalent?

There is a controlled foreign corporation (a "CFC") regime in Israel. A CFC is a foreign resident company (i) the shares of which are not listed for trading on a stock exchange (or if listed, less than 30% of the shares or other rights have been issued to the public); (ii) the majority of its income in a tax year is passive income or the majority of its profits are derived from passive income; (iii) the passive income of such company is subject to tax in the foreign jurisdiction at a rate of 15% or less; and (iv) the foreign company is controlled by Israeli residents (i.e., Israeli residents hold over 50% of the interests in the foreign company, or over 40% of the interests in the foreign company and together with the holdings of related parties, hold over 50%, or if an Israeli resident has veto power over major company decisions).

If a foreign company is a CFC, a "controlling shareholder" of such CFC (generally, a shareholder that holds 10% or more of one or more of the means of control of the CFC, taking into account certain attribution rules), is required to include in its annual income, its allocable share of the CFC's undistributed profits.

11. Is there a transfer pricing regime? Is there a "thin capitalization" regime? Is there a "safe harbour" or is it possible to obtain an advance pricing agreement?

There is a transfer pricing regime in Israel that, similar to other jurisdictions, requires related parties to a cross-border transaction, to report such transaction on the basis of its fair market value. Applicable regulations provide detailed and specific guidelines with regard to the application, establishment and documentation of the arm's length conditions that apply, and further stipulate certain methods that should be used in order to determine fair market value such as the price comparison method, the profitability comparison method and the profit and loss allocation method.

An updated transfer pricing study along with an intercompany agreement based on such study should be readily available and, upon request, submitted to the ITA. The tax-assessing officer has the authority to demand a transfer pricing study at any time within 30 days. In addition, the taxpayer is required to describe the terms of any cross-border transaction with a party with whom it has a special relationship (price, conditions and the price and conditions of an arm's length transaction) in a designated form attached to its annual tax return.

Generally, taxpayers may obtain a pre-ruling from the ITA before filing their tax returns. In the context of the transfer pricing rules, a taxpayer may apply for an advanced pricing agreement.

The ITA published two safe harbour circulars stating the ITA's expected profit levels for marketing services and for low-risk distributorship activities carried out in Israel by multinational entities, as well as providing guidance on non-value-added services.

The ITA issued a circular addressing the burden of proof in transfer pricing audits. In accordance with said circular, the filing of a transfer pricing study, in and of itself, does not shift the burden of proof from the taxpayer to the ITA. The transfer pricing study will first be reviewed by the ITA to verify it complies with domestic law requirements. For example, where the facts underlying the transaction are in dispute, or the tax inspector disagrees with the type of transactions conducted between the parties, then the taxpayer is still required to prove those facts, and the submission of the transfer pricing study is not sufficient to shift the burden of proof to the ITA. An additional case in which the burden of proof will not shift from the taxpayer to the ITA despite the filing of a transfer pricing study includes an incomplete transfer pricing study (i.e., a study missing a complete search process, missing the reasoning for choosing the applicable transfer pricing method, missing the reasoning for choosing the comparables or missing financial data of comparables).

There are no thin capitalisation rules under Israeli tax laws although financing arrangements are generally subject to arm's length principles and thus should reflect market interest rates.

12. Is there a general anti-avoidance rule (GAAR) and, if so, how is it enforced by tax authorities (e.g. in negotiations, litigation)?

There is a long-standing and well established general anti-avoidance provision in Israel's tax law that permits a tax-assessing officer to disregard a transaction that is artificial or fictitious, or one the principal objectives of which are an improper avoidance or reduction of tax. Moreover, general anti-avoidance doctrines that are common in other countries such as the "substance over form" and "step-transaction" doctrines have been adopted by Israeli courts. There are also several specific anti-avoidance provisions, as well as regulations that impose various disclosure requirements with respect to certain defined categories of transactions or tax positions.

From our experience, the ITA is not hesitant in invoking its authority under the general anti-avoidance provision, including litigating disputes on this basis, although the ITA is generally responsive to conducting pre-litigation negotiations with taxpayers in an attempt to resolve disputes before they reach the courts.

13. Is there a digital services tax? If so, is there an intention to withdraw or amend it once a multilateral solution is in place?

No digital services tax has been adopted.

14. Have any of the OECD BEPS recommendations, including the OECD's recent two-pillar solution to address the tax challenges arising from digitalisation of the economy, been implemented or are any planned to be implemented?

Israel has ratified the Multilateral Convention to Implement Tax Treaty Related measures to prevent Base Erosion and Profit Shifting ("MLI"), which was signed by the Minister of Finance on 7 June, 2017. The MLI is generally applicable with respect to the relevant Israeli tax treaties starting January 1, 2019, with several provisions to apply 6 months after the second party to the tax treaty ratifies the MLI. The changes to the double tax treaties provided for in the MLI will apply to the Israeli bilateral tax treaties currently in effect but only with respect to the treaties with countries that have also ratified the MLI in their respective countries, and furthermore only with respect to the provisions on which both countries have not submitted reservations to the OECD.

The MLI includes provisions that will be added to the existing treaties as well as replacement provisions for some of the existing provisions. The main provisions of the MLI are the following: (i) treaty abuse prevention; (ii) Mutual Agreement Procedure; (iii) permanent establishment; (iv) inter-company dividends; (v) taxation of real estate companies and (vi) arbitration. Except for the treaties with the United Kingdom, Germany and Switzerland with whom Israel has signed (or will sign) new bilateral treaties or protocols, Israel has chosen to implement the MLI on most of its existing treaties. Israel has submitted some reservations to the MLI provisions, including with respect to the arbitration provision.

At this point, no proposed legislation has been introduced with respect to the two-pillar solution. In the beginning of August 2024, the Israeli Minister of Finance announced that Israel will move forward with legislating a qualified domestic minimum top-up tax ("QDMTT") in accordance with the OECD's "two pillar solution". According to the announcement, the QDMTT legislation, which will ensure that all Israeli resident companies that are members of in-scope multinational groups pay the minimal 15% tax, will come into effect starting in 2026. The Pillar Two taxes generally apply to groups that meet the required annual revenue threshold of € 750 million. It appears, at least currently, that the intention of the Ministry of Finance is to limit the application of the global minimum tax only to multinational groups, consistent with the OECD's minimal requirements for the global minimum tax in this respect, and not to adopt the income inclusion rule (IIR) or undertaxed profits rule (UTPR).

15. How has the OECD BEPS program impacted tax policies?

We expect to see amendments to domestic legislation, adoption of regulations and the publication of guidance and ITA positions as well as entering into treaty discussions with Israel's treaty partners, aimed at implementing the OECD recommendations. As noted, Israel has ratified the MLI the implementation of which has begun.

The Finance Committee of the Knesset (Israel's Parliament) recently finalized the approval of changes to the Israeli Income Tax Ordinance and to applicable transfer pricing regulations to include Master File and Country by Country Report concepts and has updated applicable transfer pricing reporting obligations. Among these changes, the Master File threshold has been set at NIS 150 million (roughly Euro ~37 million), and generally follows the OECD Master File template, however with some adjustments which widen the reporting scope for Israeli companies, such as providing the group's organizational charts (including geographic location of employees) and a description of the group's service agreements. With respect to the Local File, it is generally required to be submitted within 30 days of request by the ITA, with the following additional information now required to be included in the transfer pricing study: (i) a table detailing (on a no-name basis) the senior level job descriptions and group structure; (ii) a list of the entities' competitors; and (iii) a description of the main agreements.

In addition, the ITA has independently been taking steps in this direction. For example, in 2016 the ITA published guidance addressing income taxation of non-Israeli Internet companies selling goods or providing services to the Israeli market through the Internet as well as the VAT liability of Internet services companies. The guidance generally provides new and broader interpretations to the definitions of a permanent establishment through dependent agents and fixed places of business and expands the VAT registration obligation of non-Israeli companies active in the Israeli market. In addition, and consistent with the OECD's so-called “nexus approach” relating to intellectual property preferential tax regimes, existing legislation provides for preferential tax rates to technology and hi-tech companies with respect to income derived from intellectual property development activities carried out in Israel (see more below).

16. Does the tax system broadly follow the OECD Model i.e. does it have taxation of: a) business profits, b) employment income and pensions, c) VAT (or other indirect tax), d) savings income and royalties, e) income from land, f) capital gains, g) stamp and/or capital duties? If so, what are the current rates and how are they applied?

Yes, it generally does. Israel is party to over 50 double tax treaties that are in force which, with the exception of a few older treaties, generally follow the OECD Model Convention. As noted, Israel has also signed and ratified the MLI.

General tax rates:

The general corporate income tax rate is 23%. There are preferential corporate tax rates that may be applicable subject to meeting certain conditions (see more below).

Employment income of individuals is subject to graduated tax rates up to a 47% marginal tax rate, and an additional 3% surcharge applicable to taxpayers with annual income over a given threshold (roughly, US $197,000 for 2024). There are several pension fund plans, contributions to which may benefit from tax exemptions. Employers and employees are required to pay NII fees as well.

VAT is charged on transactions in Israel and on the importation of goods into Israel, currently imposed at a rate of 17%. Certain transactions may qualify for a zero-rate VAT.

Royalties, capital gains and income from real estate of Israeli corporate taxpayers are generally subject to the corporate income tax rate (currently, 23%).

There are no stamp or duty taxes in Israel.

17. Is business tax levied on, broadly, the revenue profits of a business computed in accordance with accounting principles?

Yes. The tax base for the Israeli income tax is generally the taxpayer's net income, as determined under Israeli accounting principles, and adjusted in accordance with the provisions of the tax law and applicable regulations. As a general rule, Israeli taxpayers must report their income for accounting and tax purposes according to the accrual method of accounting.

There are differences between the accounting rules and the tax rules, which are set out in the tax law and regulations. The principal differences relate to depreciation and amortisation; limitations on deductibility of certain expenses; and accounting income derived under the grouping rules generally inapplicable for tax purposes.

18. Are common business vehicles such as companies, partnerships and trusts recognised as taxable entities or are they tax transparent?

Yes. While the main form of conducting business is a limited company, there are several other entities that may be utilised, including partnerships and other forms of transparent entities such as family companies, trusts, and house companies (special companies suitable for investments in real estate).

By using an entity that is transparent for tax purposes, taxpayers can generally benefit from one level of taxation (that is, avoid the entity-level tax, which is applicable when utilising a limited company). Partnerships, for example, are a common form of incorporation in Israel utilised by investment funds, including venture capital and hedge funds. Trusts are used by high-net-worth families to effectively manage their wealth and its tax-efficient allocation among its members.

In July of 2021, the Israeli Government published for public comments a memorandum for the Law for Amendment of the Income Tax Ordinance (Partnership Taxation), 2021 (the "Memorandum"). The purpose of the Memorandum is to update the tax rules applicable to partnerships in Israel. The Memorandum is revolutionary and proposes significant changes in the taxation of partnerships and investment vehicles in Israel. The Memorandum, in its current form, is the most comprehensive and significant amendment made with respect to this matter and has wide implications. At this stage, the Memorandum has not yet materialised to legislation.

19. Is liability to business taxation based on tax residence or registration? If so, what are the tests?

Both. Please refer to question 8 above.

20. Are there any favourable taxation regimes for particular areas (e.g. enterprise zones) or sectors (e.g. financial services)?

Yes. Under domestic law, a so-called "preferred company" is entitled to a reduced corporate tax rate of 16% with respect to its "preferred income" (generally, income attributable to its "preferred enterprise"), which rate is reduced to 7.5% if the preferred enterprise is located in a specified development zone.

Benefits are generally not limited to a specific time period and there are generally no minimum investment requirements.

More significant reductions in the corporate tax rate generally apply to large companies, the profits of which are subject to a reduced 5% or 8% corporate tax, depending on the location of the manufacturing facility.

Dividends paid out of income attributed to a preferred enterprise are generally subject to tax at the rate of 20%, or such lower rate as may be applicable under a tax treaty.

There are certain other special taxation regimes, most notably a preferred tax regime offered to companies holding their intellectual property in Israel (see question 21 below) and a general participation exemption regime.

On July 25, 2023, the Knesset adopted a new law granting significant tax benefits designed to strengthen the Israeli high-tech industry by granting Israeli high-tech companies and their investors various tax incentives. The law was enacted as a temporary order, which is valid until December 31, 2026 with the possibility for an extension to the extent the law achieves its goals, and offers several benefits including: (i) tax credits for an individual investor (or a group of individuals) based on the investor's investment in shares of a high-tech company; (ii) an exemption for an individual investor from capital gains tax deriving from the sale of shares in a company that is entitled to the so-called "Preferred Enterprise" tax regime and has a "Technological Plant", if the individual invested in shares of another high-tech company in close proximity to the sale (i.e., investment rollover); (iii) recognition of an Israeli company's investment in shares in a high-tech company as an expense for tax purposes over a period of five years; (iv) a tax exemption for interest paid by a high-tech company to a foreign financial institution; and (v) an extension of the validity of the temporary order allowing, in certain circumstances, the recognition of an investment in shares in listed high-tech companies as a loss, and easing some of the conditions established therein. Each of the benefits is subject to detailed eligibility rules and conditions.

21. Are there any special tax regimes for intellectual property, such as patent box?

Yes. A law that came into effect on January 1, 2017, introduced a new intellectual property regime (the "IP Regime") in Israel applicable to technology and hi-tech companies that develop their intellectual property in Israel. Companies that qualify under the IP Regime would benefit from a reduced preferential corporate tax rate of 12% on qualifying income (which rate is reduced to 7.5% in certain specified development zones). In certain cases concerning multinationals (in general, where the turnover of the company is higher than NIS 10 billion), the applicable tax rate can be reduced to only 6%.

In order to be entitled to these benefits, the said law sets out certain convoluted conditions the purpose of which is to ensure that the benefits will be provided only when the intellectual property is actually developed in Israel.

Various reliefs are available under domestic law for companies that are involved in research and development (for example, permitting accelerated amortization of research and development costs).

22. Is fiscal consolidation permitted? Are groups of companies recognised for tax purposes and, if so, are there any jurisdictional limitations on

what can constitute a tax group? Is there a group contribution system or can losses otherwise be relieved across group companies?

Consolidated tax returns are generally not allowed under Israeli law; an exception applies, however, in the case of an Israeli-resident "industrial" company or a company that is a holding company of industrial companies. An industrial company is a company that receives at least 90% of its revenues from an industrial facility engaged in manufacturing activities including software and other high-tech companies' activities. An industrial company, or an industrial holding company, may file a consolidated tax return on behalf of itself and its industrial company subsidiaries, provided that all the industrial companies included in the consolidated group are part of a single assembly line or manufacturing process.

23. Are there any withholding taxes?

Israel maintains a broad withholding system applicable to both domestic and outbound payments.

For example, Interest payments to corporate entities are generally subject to withholding tax at the standard corporate tax rate level (currently 23%) unless a withholding certificate providing for a lower rate (or exemption) is provided. Payments to non-Israeli residents may be eligible for reduced rates of withholding under a tax treaty.

For withholding from dividend payments, please refer to question 25 below.

Other payments to non-Israeli companies (such as capital gains derived from the sale of an asset located in Israel) are generally subject to the standard corporate tax rate, collected via withholding. Certain exemptions with respect to the sale of securities may be applicable under domestic law or a tax treaty.

24. Are there any environmental taxes payable by businesses?

No.

25. Is dividend income received from resident and/or non-resident companies taxable?

Dividends paid from one Israeli resident company to another are generally exempt from withholding to the extent dividends are distributed from income that generated or accrued in Israel and was subject to regular corporate income tax rates.

Dividends from an Israeli resident company to a non-Israeli resident company are generally subject to withholding at a rate of 25%, which rate is increased to 30% if at the time of the distribution or at any time during the 12-month period preceding the distribution, the recipient of the dividend is, or was, a "substantial shareholder" (generally, a shareholder that holds 10% or more on one of the means of control of the company paying the dividend). A reduced rate may be applicable under a double tax treaty.

Dividends distributed from a preferred enterprise are generally subject to a reduced 20% withholding rate. In addition, dividends paid from certain qualifying income under the IP Regime will also generally be subject to a reduced 20% withholding rate, which rate is reduced to 4% to the extent the dividends are paid to a non-Israeli company and certain other conditions are met (including a minimum 90% holding threshold).

Dividends that an Israeli resident company receives from abroad are subject to the standard corporate tax rate (currently 23%), with a possibility to obtain a direct and indirect foreign tax credit with respect to taxes withheld abroad.

26. What are the advantages and disadvantages offered by your jurisdiction to an international group seeking to relocate activities?

Israel is a member of the OECD and generally follows OECD principles with respect to taxation. Israel is also a party to over 50 double tax treaties which facilitate cross-border transactions and provide protection against double taxation.

Israel generally encourages, through incentive legislation and other programs, inbound investment and outbound exports aimed at strengthening its economy, including enacting and continuously simplifying laws that provide various tax benefits, reduced corporate tax and dividend withholding rates, such as the new IP Regime.

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