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Israeli Tax Updates

Quarterly International Tax Update – Israel's Latest Legislative and Regulatory Developments

We are pleased to share our latest Quarterly Tax Update, summarizing key legislative and regulatory developments in Israel that may be relevant to international businesses and investors. We hope you find this information useful and welcome any inquiries or discussions regarding its implications for your operations.

A New Voluntary Disclosure Procedure Has Been Published

The Israel Tax Authority has published the new Voluntary Disclosure Procedure, offering a crucial, potentially final, opportunity for individuals and entities to rectify undeclared tax violations, including income from digital assets (newly regulated), financial assets held abroad, and rental properties. Compliance with the procedure grants criminal immunity from tax offenses, provided certain key conditions are met: the application must be genuine and in good faith, involve full disclosure of all facts, and include payment of the entire tax liability (principal, linkage differences, interest, and often penalties). Applications can be submitted until August 31, 2026. Taxpayers must utilize this limited window to correct their reports, with solutions available to manage the tax payment even when funds are held in foreign financial institutions.

Important for Prospective Olim: Reporting Exemption Expires From 1 Jan 2026 — New Residents Must Disclose Global Assets

From January 1, 2026, the longstanding reporting exemption for new immigrants and veteran returning residents will be terminated: individuals who become Israeli tax residents on or after that date will no longer benefit from the exemption and will be required to disclose worldwide assets and income (including trusts and foreign entities) to the Israel Tax Authority.
However, it is important to note that new immigrants and veteran returning residents that will become Israeli tax residents after January 1, 2026, will still enjoy the same exemption on foreign-sourced income that has existed since 2007. The change relates solely to the duty to report, not to the 10-year tax holiday on foreign sourced income.

Are Franchise Fees to IKEA Global Considered Royalties? New District Court Ruling

On August 7, 2025, the Tel Aviv District Court ruled that payments of 3% of gross monthly sales to Inter IKEA Systems B.V. (Netherlands) should be treated as royalties rather than service fees. The Court rejected the taxpayer's argument that the payments reflected a broad package of ongoing services, instead finding that the essence of the arrangement was the use of IKEA's powerful trademarks, business model, and proprietary know-how. As such, the payments constituted royalties under both the Israeli Income Tax Ordinance and Article 13 of the Israel–Netherlands tax treaty, triggering a 5% withholding tax obligation. The ruling mirrors the earlier Central Bottling Company (Coca-Cola) case, reinforcing the Israel Tax Authority's position that franchise and brand-use payments tied to sales performance are royalties.

Israeli Tax Court Upholds Corporate Veil in Defining "Beneficial Owner" of Dividends

The Tel Aviv District Court recently issued a significant supplementary ruling (July 2025) in the Gottex Swimwear case, clarifying the scope of the Ultimate Beneficial Owner (UBO) principle under the Israel-Netherlands Tax Treaty regarding dividend distribution. The Court rejected the Tax Authority's contention that the ultimate controlling Israeli individuals were the UBO, a claim aimed at denying the reduced 5% withholding tax rate according to the treaty. Instead, the Court ruled that the Dutch holding company (Findings B.V.) was the rightful UBO. The judgment emphasizes that the UBO is the entity with the legal and substantive capacity to freely determine the use of the income, effectively distinguishing a true holding company from a mere "conduit company." Crucially, the ruling confirms that the UBO is not necessarily the ultimate recipient of the funds, thus reinforcing the principle of separate legal personality and cautioning against lifting the corporate veil solely for the purpose of increasing the tax rate. This decision reinforces treaty benefits for legitimate holding structures.

Employee Stock Options & Carried Interest: ITA Clarifies New 2% Additional Tax on High Capital Income

Following the 2025 legislative amendments introducing a new 2% Passive Capital Additional Tax (surtax) on high capital income, the Israel Tax Authority (ITA) has provided essential guidance in Professional Position Paper No. 8 (July 2025). The paper clarifies that for Employee Stock Options under Section 102, the new 2% tax applies only to the capital gain component realized upon exercise (or sale, as per the track), and does not apply to the ordinary income component (the labor component). Furthermore, the ITA confirmed its longstanding view that Carried Interest (Success Fees) received by General Partners in investment funds is classified as ordinary business income (Section 2(1)/(2)). Consequently, while this income remains subject to the existing 3% Global Additional Tax on high income (surtax), the new 2% passive capital tax explicitly does not apply on it. This clarification provides much-needed certainty to the high-tech and investment fund sectors regarding the tax liability of key compensation mechanisms.

Israel Proposes Major Shift in Individual Tax Residency: Introducing Irrefutable Day-Count Tests

A new Draft Bill (published July 2, 2025) proposes significant amendments to the definition of "Israeli Resident" for tax purposes, moving away from the purely qualitative "center of life" test. This recent Draft Bill follows a similar Draft Bill published in July 2023. While the current law includes rebuttable presumptions based on days of presence in Israel (183 days or the 425-day test), the new proposal introduces irrefutable (final) presumptions for both Israeli residency and foreign residency, to be determined solely by the number of days an individual is physically present in Israel. This change, which follows similar reform recommendations, is intended to increase tax certainty and reduce ambiguity by providing clear, objective thresholds for residency status in clear-cut cases. Taxpayers should prepare for a potential shift in how their residency is determined, moving toward more rigid, quantitative criteria.

For any questions or further clarification on this matter, please feel free to reach out to our team:

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