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Israeli Tax Updates

International Tax Update – Israel's Latest Legislative, Regulatory and Case Law Developments

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

Law for Encouraging Aliyah to Israel and Return Thereto (Temporary Provision) Tax Benefit for Earned Income Generated in Israel by New Immigrants and Long-Term Returning Residents

A new law provides a temporary tax benefit for individuals who will become Israeli resident for the first time as new immigrants, or as long-term returning residents, during the period from November 5, 2025 through December 31, 2026, provided that they do not cease to be Israeli residents during 2028 or 2029 and are present in Israel for at least 75 days in each of those years. The benefit applies only to qualifying earned income generated in Israel, namely taxable personal exertion income, and not passive income and is in addition to the existing benefits for non-Israeli sourced income under Section 14 of the Income Tax Ordinance. The benefit includes an income tax exemption, subject to annual caps decreasing over five years: ILS 600,000 in 2026, ILS 1,000,000 in 2027 and 2028, ILS 350,000 in 2029, and ILS 150,000 in 2030.

Law for Encouraging Aliyah to Israel and Return Thereto (Temporary Provision), 5786-2026, published on March 31, 2026.

Minimum Corporate Tax in a Multinational Group – Implementing the GloBE Rules

On December 31, 2025, Israel enacted the Minimum Corporate Tax in a Multinational Group Law, 5786-2025, implementing the Qualified Domestic Minimum Top-up Tax (QDMTT) mechanism as part of the OECD's Pillar Two framework. The law is limited to the QDMTT mechanism and does not include the Income Inclusion Rule (IIR) or the Undertaxed Profits Rule (UTPR). Its purpose is to ensure the payment of a minimum tax in Israel by multinational groups in Israel, in accordance with the OECD's BEPS principles, at a minimum tax rate of 15%.
The regime applies to Israeli constituent entities, including Israeli-resident entities and permanent establishments in Israel, that are part of a multinational group with annual consolidated revenue of at least EUR 750 million in at least two of the four fiscal years preceding the tested fiscal year. The law entered into force on January 1, 2026, and applies from the first tax year beginning on or after January 1, 2026. It also includes a dedicated Israeli compliance framework, including reporting obligations, a representative-entity mechanism, assessment and collection procedures, monetary sanctions for non-compliance, and an express provision that the law is to be interpreted in light of the English text of the GloBE rules and the related OECD commentaries and guidance.

Minimum Corporate Tax in a Multinational Group, 5786-2025, enacted December 31, 2025.

Draft Order on Encouraging and Promoting R&D – Cash Grant in Lieu of an R&D Tax Credit

The draft order was published in the context of the proposed Economic Efficiency Law for the 2026 budget year, which included a proposal to enact the Encouragement and Promotion of Research and Development Law, 5786-2026, providing tax incentive in the form of a credit for research and development expenses incurred in Israel. That law was subsequently enacted and published on March 31, 2026.The explanatory notes state that the need for the new mechanism arises from changes in the global tax regime, foremost among them legislation enacted in many countries imposing a minimum corporate tax in accordance with the Pillar Two model led by the OECD, which may significantly erode the effectiveness of Israel's existing tax incentives under the Law for the Encouragement of Capital Investments and impair Israel's attractiveness to knowledge-intensive companies.
Against this background, and in light of the authorization under Section 8 of the law, is the draft order proposes that a "qualified company", namely a company eligible for a tax credit under Section 2 of the law, that has not utilized that tax credit by the end of the third year following the R&D activity year, may submit during the fourth year a notice requesting payment of the full unused credit as a grant. The draft order also proposes rules governing payment of the grant within 90 days from submission of the notice, subject to the possibility of delaying payment if reports required under Sections 131 or 135 of the Income Tax Ordinance have not been filed, and of suspending that period where additional requested information or documents have not been provided. In addition, the draft order proposes to allow a company to notify in advance, already as part of the application for the credit, that it waives utilization of the credit against its income tax liability or domestic top-up tax liability and instead requests payment of the full amount as a grant. The explanatory notes further state that the mechanism is intended to support classification of the benefit as a Qualified Refundable Tax Credit under the OECD rules, and that a further purpose of the advance-waiver mechanism is to ensure that the benefit is treated as a grant, rather than as a tax credit, also for purposes of the GILTI rules under U.S. tax law.

Draft Order - Encouragement and Promotion of Research and Development (Grant in Lieu of Tax Credit), 5786-2026, published on February 25, 2026.

Income Tax Circular 8/2025 – Attribution of Income to Research and Development (R&D) Centers

The Israel Tax Authority published Circular 8/2025 that addresses the Israeli tax treatment of R&D services provided from Israel to a multinational group through an Israeli-resident related party. The circular sets out work procedures applicable in assessment proceedings and presents the Israel Tax Authority's position regarding the tax aspects of such arrangements. The circular reflects the importance attributed to multinational R&D activity in Israel and is intended to increase tax certainty, promote a uniform policy, prevent double taxation, and ensure appropriate taxation in Israel. Under the circular, any assertion that the transfer pricing method should be changed from the cost-plus method (Cost Plus) to another method requires approval from senior officials in the professional division of the Israel Tax Authority, and in certain cases even written approval from the Director of the Israel Tax Authority. Approval by senior officials is also required where it is asserted that the cost-plus markup should exceed 14%.
In addition, the circular proposes a framework for obtaining several types of tax rulings in order to increase certainty for taxpayers. These include rulings relating to the acquisition of an Israeli company by a foreign corporation combined with a transition to a limited-risk R&D model and the sale of intangible property, rulings confirming that indemnification received by an Israeli limited-risk R&D company is at arm's length, and advance pricing arrangements between jurisdictions.

Income Tax Circular 8/2025, published on November 2, 2025.

Economic Efficiency Bill for 2026 – Tax Brackets, Aliyah Incentives, Pension Taxation, Online Platforms and Cash Restrictions

On January 19, 2026, the Economic Efficiency Bill for the 2026 budget year was published. The bill includes measures aimed at preserving fiscal discipline, increasing state revenues and broadening reporting obligations. Among other things, it proposes changes relating to the widening of tax brackets and a tax benefit for new immigrants and returning residents in respect of earned income.
In the area of institutional savings, the bill proposes alignment between tax law and capital market supervision rules, so that a holding permitted under the supervision rules would not be regarded as "control" or a "material holding" for purposes of the relevant exemption, subject to implementation by order of the Minister of Finance and approval by the Knesset Finance Committee.
In addition, as part of the effort to combat the black economy, the bill proposes an annual reporting obligation for operators of online platforms that rent out Israeli real estate with respect to reportable users, together with information collection, verification and record-retention obligations, as well as administrative sanctions. The bill also proposes an amendment to the Cash Law so that restrictions would apply not only to payments in cash, but also to the exchange of banknotes into cash above the applicable threshold, subject to a limited exception.

Economic Efficiency Bill (Legislative Amendments for Achieving the Budget Targets for the 2026 Budget Year), 5786-2026, published on January 19, 2026.

Income Tax Circular 9/2025 – Taxation of Equity Awards Granted to Employees Who Were Foreign Residents and Became Israeli Residents

Income Tax Circular 9/2025 addresses the taxation of options and RSU instruments (Restricted Stock Units) granted by a foreign company that does not qualify as the employee's employer, while the employee was a foreign resident and were exercised after the employee became an Israeli resident. The circular clarifies that the default position is taxation under Section 3(i) of the Income Tax Ordinance as employment income, based on an apportionment between workdays in Israel and workdays abroad. The portion attributable to employment abroad will generally be exempt in Israel, while the Israeli portion will be taxed at marginal rates.
At the same time, the circular allows a transition to the capital gains track under Section 102, subject to meeting the relevant conditions and appointing a trustee. Where this alternative applies, the remaining gain may be taxed as capital gain. The circular also expands on the possibility of spreading the income over up to six tax years.

Income Tax Circular 9/2025, published on November 11, 2025.

Income Tax Circular 01/2026 – Definition of a "Closely Held Company"

The Israel Tax Authority published Income Tax Circular 01/2026 setting out its position on the definition of a "closely held company" under Section 76 of the Income Tax Ordinance. This definition is relevant to a number of anti-avoidance provisions, particularly in relation to private companies with a limited number of shareholders. According to the circular, a company will be considered closely held if it satisfies three principal conditions: it is controlled directly or indirectly by no more than five persons, it is not a Subsidiary as defined in the circular, and the public does not have a material interest in it. The circular also explains how control is assessed, including by taking into account options and other rights to acquire shares, and clarifies which companies are considered to have a material public interest.

Income Tax Circular 01/2026, published on January 20, 2026.

Income Tax Circular 7/2025 – Sections 81A–81F of the Income Tax Ordinance: Additional Tax on Undistributed Profits of a Closely Held Company

The Israel Tax Authority published Circular 7/2025 regarding the implementation of part of Amendment 277 to the Income Tax Ordinance, dealing with the taxation of "trapped" profits. Sections 81A–81F impose an additional 2% tax on the undistributed profits of a closely held company. The circular explains the new tax mechanism and the relevant definitions, sets out how the excess profits subject to the additional tax are calculated, and addresses the collection and payment dates. It also describes various mechanisms intended to prevent the additional tax from applying where profits are invested in productive activity and includes guidance on the transitional provisions of the amendment.

Income Tax Circular 7/2025, published on February 8, 2026.

Income Tax Circular 04/2026 – Updated Guidelines for Completing Form 150

On February 18, 2026, Income Tax Circular 04/2026 was published, setting out updated guidelines for completing Form 150, the appendix to the annual income tax return concerning holdings in foreign companies or corporations, applicable starting with the 2023 tax year. The form applies to Israeli residents, whether individuals or companies, that hold rights in foreign entities, including where the taxpayer was an Israeli resident for only part of the year or sold their rights during the year. The purpose of the reporting is to enable the Israel Tax Authority to examine various tax consequences, including whether a foreign company may be regarded as managed and controlled from Israel, or whether Israeli taxation may apply to profits of foreign corporations under regimes such as the controlled foreign corporation rules or the foreign vocation company rules.

Income Tax Circular 04/2026, published on February 18, 2026.

Tax Ruling 3986/26 – Withholding Tax Arrangement Upon the Acquisition of Shares in an Israeli Company Traded on a Foreign Stock Exchange

Tax Ruling 3986/26 sets out a withholding tax arrangement for the acquisition of shares in an Israeli company traded on a stock exchange outside Israel, particularly where it is difficult to identify all shareholders. The ruling concerned an Israeli software development company traded abroad and not holding Israeli real estate assets, whose entire share capital was to be acquired for cash in an off-exchange transaction. The ruling distinguishes between "Public Shareholders," whose shares are held through foreign financial institutions or Israeli exchange members and whose holdings are below 5%, and all other shareholders.
Under the ruling, the transfer of the consideration attributable to Public Shareholders from the acquiring company to the foreign paying agent trustees is exempt from withholding tax. When the consideration is transferred to the foreign paying agent trustees, non-resident shareholders who declare their entitlement to an exemption may receive the consideration without withholding. Israeli exchange members will also receive the consideration without withholding, but they will be responsible for withholding tax themselves. With respect to all other shareholders, withholding tax is to be deducted in accordance with the Income Tax Ordinance and the regulations, and the Israeli trustee will be jointly responsible with the acquiring company for remitting the tax to the Israel Tax Authority.

Tax Ruling No. 3986/26, Capital Markets, published on January 29, 2026.

Dividends Paid to Employees Under Section 102 (Capital Gains Track) Taxed at 25% – Not at Reduced Rates Under the Encouragement Law

The Supreme Court accepted the Assessor's appeal, reversed the District Court's judgment, and held that a dividend distributed to employees whose shares are held by a trustee under the capital gains track of Section 102 of the Income Tax Ordinance does not qualify for the reduced tax rates under the Law for the Encouragement of Capital Investments. The Court held that the right to receive a dividend is a right conferred by virtue of the share, and that under the Section 102 mechanism and the rules promulgated thereunder, the dividend is part of the bundle of rights held by the trustee. The Court further held that the transfer of the dividend to the employees during the restrictions period in which the shares are held by the trustee constitutes an "exercise" for purposes of Section 102 of the Income Tax Ordinance, and therefore the dividend is subject to the tax rate prescribed in Section 102(b)(2) of the Income Tax Ordinance, namely 25%, rather than the withholding tax rates applied under the Encouragement Law - 15% with respect to dividends sourced in "Benefited Income" and 20% with respect to dividends sourced in "Preferred Income".

CA 4077/23 Rehovot Assessing Officer v. Conduit Ltd., judgment dated March 19, 2026.

Reciprocal Loans, Preferred Shares and a "Preferred Dividend" Mechanism Classified as Additional Consideration in a Share Sale Transaction

The taxpayers sold shares in a company and argued that part of the amounts they received constituted loans and a preferred dividend that were not part of the consideration subject to capital gains tax. The Court held that the agreements, taken as a whole, reflected a single integrated transaction, and that the amounts presented as a "loan" and as a "dividend" were neither a loan nor a dividend, but rather additional consideration paid for the shares. In this context, the Court emphasized that the preferred dividend was secured through preferred shares, and that the purchaser extended a loan to the company, while the company extended a loan in the same amount to the taxpayers, and that the preferred share mechanism, together with the reciprocal loan mechanism, effectively reflected an agreement on total consideration for the shares. The Court held that the loan was ultimately repaid through the preferred dividend distributed in respect of the preferred shares. The Court further held that this conclusion followed from classifying the transaction and its components according to their substance, without the need to rely on Section 86 of the Income Tax Ordinance. The Court added, however, that it would have reached the same result, in the alternative, by way of tax recharacterization. The taxpayers' claim to offset a capital loss arising from a waiver of a debt owed by a foreign company was also rejected, as the existence of a capital loss in the relevant tax year was not established, inter alia, in light of the timing of the waiver, additional capital injections into the company, attempts to bring in a new investor, the failure to produce the company's financial statements, and the fact that the foreign company was a related party. On the issue of imputed interest under Section 3(i) of the Income Tax Ordinance, the Court held that, with respect to a loan for which capital notes were issued, such issuance may be recognized even if made retroactively, and therefore no imputed interest arises. By contrast, the arguments concerning the other loans were rejected due to insufficient evidentiary support regarding the borrowers' financial condition or the prospects of collection, and in one case the Court noted that most of the loan amount had in fact been repaid.

IT App. 52941-01-21 A.A.A. Empire Assets (2011) Ltd.; IT App. 52960-01-21 Zino Holdings (A.Z. - 2014) Ltd. v. Rehovot Assessing Officer, judgment dated March 12, 2026.

Contributions to Private Insurance Policies Under a Deferred Compensation Arrangement Constitute Employment Income at the Time of Contribution

The District Court dismissed an appeal filed by private companies within the SAP international group and held that contributions they made to private insurance policies, which are not approved provident funds, under a deferred compensation arrangement for senior employees, constitute the employees' employment income already at the time the contributions are made, and accordingly the companies were required to withhold tax at source at that time. In its reasoning, the Court also addressed the distinction between formal ownership and economic ownership, as well as the law of trusts, including the constructive trust doctrine, and examined who bore the risk in the funds, who enjoyed their proceeds, whether it was established that the policies were exposed to the employer's creditors, who was authorized to change the investment track or the insurer, who was entitled to withdraw the funds, and whether the employer had any business use of them. Based on the overall picture, the Court held that despite the taxpayers' formal ownership of the policies, the employees were the economic beneficiaries of the funds, and that an employee who instructs an employer to deposit part of the employee's salary into a private policy is regarded as making use of that salary. At the same time, the Court held that a penalty for failure to withhold under Section 191A of the Income Tax Ordinance should not be imposed in the circumstances, since the taxpayers' position was recognized as a legitimate, albeit erroneous, interpretation. The Court further held that upon retirement, effect must be given to the fact that tax had already been paid on the principal amounts at the time of contribution.

IT App. 60005-01-23 SAP Labs Israel Ltd.; IT App. 53844-05-23 SAP Israel Ltd.; IT App. 47141-02-23 SAP Portals Israel Ltd.; IT App. 59984-01-23 SAP Israel Ltd. v. the Assessing Officers, judgment dated March 11, 2026.

L.L.D. Diamonds Ltd. v. Gush Dan Assessing Officer

In Tax Appeal 71029-01-20, the Tel Aviv District Court largely dismissed the appeal of L.L.D. Diamonds Ltd., which challenged capital gains tax assessments issued in connection with the sale of rights in three U.S. LLCs held through another U.S. company. The case followed a 2006 tax ruling that had approved, on a tax-deferred basis, a restructuring of the taxpayer's group holdings, under which rights in U.S. diamond businesses were transferred to a U.S. holding company. The court held that the ruling provided only tax deferral and did not shift the Israeli tax liability away from the taxpayer, notwithstanding that the direct seller was another U.S. entity. The court further held that the tax event occurred when the substantive economic rights in the LLC interests, including the right to profits, ceased to exist, which the court found had occurred in 2013 or, at the latest, in 2014, even though the formal legal separation was completed only later.
As to the tax base, the court ruled that only the consideration actually received was taxable, on a cash basis, rather than the entire future consideration, because the final amount was not known at the time of the transaction. Although capital gains are ordinarily taxed on an accrual basis, the court considered cash-basis taxation justified here because the ultimate consideration was uncertain at the time of the tax event. The court rejected the taxpayer's claims regarding deduction of the investment cost and entitlement to a foreign tax credit, holding that a foreign tax credit was unavailable under the express terms of the 2006 tax ruling and, in any event, in the absence of proof that U.S. tax had actually been paid. The court likewise did not accept the taxpayer's double-taxation and treaty arguments in the circumstances. At the same time, the court accepted the appeal with respect to transfer pricing, holding that the tax authority had disallowed part of the company's diamond purchase expenses without sufficient evidentiary basis. The judgment is notable in that it treats the 2006 tax ruling as a deferral arrangement rather than as a basis for shifting the taxable person or expanding reliefs such as foreign tax credits.

Tax Appeal 71029-01-20 L.L.D. Diamonds Ltd. v. Gush Dan Assessing Officer, judgment dated November 26, 2025.

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

Sefi Rubin
Adv. (CPA)
Sefi@maslaw.co.il

Shlomi Lazar
Adv. (CPA)
Shlomi.l@maslaw.co.il

Meir Mizrahi with A. Rafael & Co.

office@maslaw.co.il | Tel +972-3-6129797 | 14 Abba Hillel Silver Rd, Ramat Gan, 52506