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# Israeli Tax Updates

## Quarterly International Tax Update – Israel’s Latest Legislative, Regulatory and Case Law Developments

We are pleased to share our latest Quarterly Tax Update, summarizing key legislative, regulatory and case law 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.

### Draft Regulations Completing Israel’s Implementation of the GloBE Rules

On April 27, 2026, draft regulations were published to supplement the implementation of the Minimum Corporate Tax in a Multinational Group Law, 5786-2025, in accordance with the OECD’s GloBE Rules under Pillar Two. The law incorporates the GloBE Rules by reference; however, certain mechanisms subsequently introduced through the OECD’s Agreed Administrative Guidance and included in the May 2025 Consolidated Commentary require express implementation under Israeli law. The explanatory notes state that the regulations are also important for the recognition of Israel’s domestic minimum tax regime as a Qualified Domestic Minimum Top-up Tax and for satisfying the requirements of the QDMTT Safe Harbour.

The draft regulations include a transitional safe harbor based on a Qualified Country-by-Country Report, under which the Israeli top-up tax may be treated as zero if the group satisfies one of three alternative tests: a de minimis test, a simplified effective tax rate test or a routine profits test based on the Substance-based Income Exclusion. They also provide a permanent safe harbor allowing simplified calculations for non-material constituent entities and incorporate several elections introduced in the OECD’s Administrative Guidance, together with currency-conversion rules.

**Draft Minimum Corporate Tax in a Multinational Group Regulations, 5786-2026, published on April 27, 2026.**

### Draft Regulations Aligning the Technology Company Acquisition Incentive with Pillar Two

On June 3, 2026, draft regulations were published to adapt the Israeli tax incentive available to a technology company acquiring control of another technology company to the OECD’s Pillar Two framework. Under the existing legislation, a qualifying acquiring company may deduct the cost of acquiring the shares against its technological income in equal installments over five years. The explanatory notes state that, because the deduction reduces the company’s taxable base, it may also reduce the multinational group’s effective tax rate in Israel and thereby cause the Israeli incentive to be offset, in whole or in part, by top-up tax under the GloBE Rules.

The draft regulations therefore propose allowing the acquiring company to elect to replace the deduction with a tax credit intended to qualify as a Qualified Refundable Tax Credit. The credit would be calculated by multiplying the deduction otherwise available by the reduced tax rate applicable to the company’s technological income. Any credit not utilized by the end of the third year following the acquisition would be paid as a grant in the fourth year. The proposed mechanism is intended to preserve the economic value of the incentive under Pillar Two, allow loss-making companies to benefit from it and accelerate its realization compared with the existing deduction mechanism.

**Draft Regulations for the Encouragement of Knowledge-Intensive Industry (Temporary Provision), 5786-2026, published on June 3, 2026.**

### Israeli Tax Residency Despite Extensive Business Activities Abroad

The Tel Aviv District Court considered the Israeli tax residency of a taxpayer who had left Israel in 1985, initially for England, and moved to Nigeria in 1993, where he established and managed substantial business activities for many years. The taxpayer argued that he had ceased to be an Israeli resident upon leaving Israel and that, during the 2009–2017 tax years, he was a Nigerian resident or, alternatively, a senior returning resident. The Israel Tax Authority argued that the taxpayer’s Israeli tax residency had never been severed. Although the center of his business activities was in Nigeria, his wife continued to reside in Israel and he traveled to Israel frequently for extended stays. The Court attributed both quantitative and substantive significance to the number and pattern of days spent in Israel. The taxpayer’s frequent visits, presence in Israel during every month of the year and average stays exceeding half of each month over a period of many years indicated an established pattern of life in Israel. The Court observed that, in principle, an individual may have two centers of life simultaneously, but found it unnecessary to determine whether that was the case, since the taxpayer had not rebutted the statutory day-count presumption.

The Court also rejected the taxpayer’s claim that he and his wife had separated, finding that significant family and economic ties remained between them. Weight was also given to the limited integration in Nigeria: he did not pay Nigerian tax on most of his income, held a substantial portion of his wealth outside Nigeria and did not have permanent immigration status, instead relying on a temporary visa renewed annually. The National Insurance Institute’s determination that he had ceased to be an Israeli resident was not decisive for income tax purposes, and the absence of assessments for earlier years did not create an estoppel against the Assessing Officer. The Court therefore held that the taxpayer was an Israeli resident during the years under appeal and returned the matter to the assessment stage to determine his taxable income.

**Tax Appeal 62852-01-23 Tzach et al. v. Large Enterprises Assessing Officer, judgment dated June 1, 2026.**

### Tax Ruling 2801/26 – Attribution of Income Between Technological IP and Manufacturing Activities

The Israel Tax Authority published Tax Ruling 2801/26 concerning the attribution of income of a “Preferred Technological Enterprise” to technological assets. The ruling concerned a privately held Israeli-resident company forming part of a multinational group, which develops and manufactures complex medical devices incorporating software and based on patents owned by the company. The ruling confirmed that the company’s enterprise qualified as a Preferred Technological Enterprise and that the income derived from the sale of its products was attributable to its technological intellectual property, including its patents and software, and therefore constituted “Technological Income.”

The ruling further determined that the income from the sale of the products was also attributable to the company’s manufacturing activities and constituted “Preferred Income,” subject to the conditions described in the ruling. These conditions included the sale of the products through group distribution companies, the products being intended for the institutional market, their purchase being based on technical specifications, and the company’s marketing activities and expenses being negligible or marginal. In addition, income from manufacturing services provided to the foreign parent company under a cost-plus arrangement was attributed entirely to the enterprise’s manufacturing activities and also constituted “Preferred Income.”

**Tax Ruling No. 2801/26, concerning the attribution of income of a Preferred Technological Enterprise to technological assets, published on April 12, 2026.**

### Supreme Court Rejects Constitutional Challenges to the Undistributed Profits Tax Regime

The Israeli Supreme Court, sitting as the High Court of Justice, dismissed two petitions challenging the legislation commonly referred to as Amendment 277 to the Income Tax Ordinance. The legislation introduced two principal arrangements applicable to closely held companies: an expansion of the circumstances in which a company’s income may be attributed to its shareholders under Section 62A of the Income Tax Ordinance, and the imposition of an additional 2% tax on certain excess profits that remain undistributed. The petitioners argued, among other matters, that the arrangements infringed constitutional rights, applied too broadly to companies that were not personal-service or “wallet” companies, relied on arbitrary tests and operated retroactively.

The Court rejected these arguments, holding that the legislation was intended to address the misuse of the two-tier corporate taxation model and that the legislature enjoys broad discretion in designing tax legislation. The Court further held that the arrangements did not constitute retroactive legislation warranting judicial intervention and that no sufficient basis had been established for finding an unconstitutional infringement of protected rights. It added that, even assuming a degree of interference with property rights, the arrangements satisfied the applicable proportionality tests. The Court also held that the application of the legislation to closely held companies was not arbitrary, noting that it included mechanisms intended to distinguish between personal-service companies and other closely held companies, and between excess profits retained without sufficient justification and profits used or expected to be used for the expansion of active business operations.

**HCI 35810-08-25 Association of Representatives et al. v. the Knesset of Israel et al.; HCI 6251-11-25 Binyanei Rubinstein Ltd. et al. v. the Knesset of Israel et al., judgment dated May 3, 2026.**

### Profits Eligible for Distribution Recognized Despite a Negative Retained Earnings Balance

The Haifa District Court accepted a tax appeal concerning the accounting alternative for calculating profits eligible for distribution under Section 94B of the Income Tax Ordinance. At the end of the tax year preceding the sale of the shares, the company whose shares were sold had a negative retained earnings balance. However, during the relevant holding period, profits earned by the company had reduced its accumulated losses. The Assessing Officer argued that where the company had a negative retained earnings balance, the amount of profits eligible for distribution under the accounting alternative was necessarily zero, since no accounting profits were available for distribution.

The Court rejected this position and held that Section 94B does not require a positive retained earnings balance at the end of the relevant period. Rather, the calculation must examine the profits actually accumulated during that period. The reference to the company’s balance sheet provides an accounting basis for the calculation but does not preclude recognition of profits generated during the relevant period merely because an accumulated loss remained at its conclusion. The Court emphasized the purpose of preventing excessive taxation where profits had already been subject to corporate tax, alongside the objective of achieving tax neutrality. Accordingly, the taxpayer was entitled to take into account the profits accumulated during the holding period even though the company had not yet reached a positive retained earnings balance.

**Tax Appeal 36830-07-23 Av-Shal Investments and Trade Ltd. v. Haifa Assessing Officer, judgment dated April 5, 2026.**

### Income Tax Circular 05/2026 – Offset of Tax Losses in Corporate Reorganizations

The Israel Tax Authority published Income Tax Circular 05/2026 concerning the unoffset of tax losses in corporate reorganizations under Part E2 of the Income Tax Ordinance. The circular reviews the loss-offset rules applicable to various types of reorganizations, including statutory mergers, mergers effected through share-exchange, asset transfers, stand-alone share exchanges and demergers. With respect to a statutory merger, the circular clarifies that ordinary losses under Sections 28 and 29 of the Income Tax Ordinance accumulated by the participating companies before the merger may be offset against the taxable income of the surviving company beginning in the tax year following the merger, subject to an annual limitation equal to the lower of 20% of the aggregate losses or 50% of the surviving company’s taxable income before the loss offset. Similar limitations apply to capital losses.

The circular also emphasizes the Director’s authority to modify the manner in which losses are utilized, extend the utilization period, reduce the portion of income against which the losses may be offset, or disallow the losses, where the reorganization lacks a business and economic purpose or is intended to achieve an improper reduction of tax. The circular also addresses asset transfers between related companies, demergers and other reorganizations, and includes examples illustrating the application of the rules.

**Income Tax Circular 05/2026, concerning the offset of losses under Part E2 of the Income Tax Ordinance, published on March 25, 2026.**



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

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