# Transfer Pricing Country Summary

## Israel

June 2022

# 1. Introduction

The current legal framework in Israel is based mainly upon Section 85A ("Section 85A") of the Israeli Tax Ordinance. Section 85A which was enacted in 2006, introduced the arm's length principle (which was previously unofficially enforced through Section 86 of the Israeli Tax Ordinance (the section which deals with artificial transactions), by asserting that an international transaction between "parties with special relationship", i.e. related parties, should be reported to the tax asserting officer and be taxed in consistence with the appropriate market price. Guidance regarding transfer pricing is incorporated under Tax Circular 3/2008 and under the regulations promulgated under Section 85A (the "Israeli TP Regulations"). The regulations promulgated under Section 85A adhere to the arm's length principle and incorporate guidelines from both the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (the "OECD Guidelines") and Section 482 of the US Internal Revenue Code ("Section 482"), towards determination of the correct analysis methods for examining an international transaction between related parties

# 2. Laws & Regulations

## a) References to OECD/EU/Local Rules

- Section 85A of the Israeli Tax Ordinance
- Section 86 of the Israeli Tax Ordinance
- Tax Circular 3/2008
- Section 482 of the Israeli Internal Revenue Code

## b) Definition of Related Party

Section 85A(b) defines the term "special relationship" relating to as the relationship between an entity (including an individual) and its relative, the control of one party to a transaction over the other, or control of one individual (or entity) over the parties to the transaction, directly or indirectly, individually or jointly with others. The term "control" is defined as "holding, directly or indirectly, 50% or more in one of the means of control". The term "means of control" include: the right to receive profits; the right to appoint directors or the general manager or other similar positions; the right to vote in the general shareholders' meeting; upon liquidation of the company, the right to a share in the equity after all debts are paid; and/or the right to determine which party will have one of the above- mentioned rights. The term "relative" means "a spouse, sibling, parents, grandparent, offspring, spouses' offspring and the spouse of each of these".

## c) Nature of Transfer Pricing Documentation

The nature of TP documentation is in line with the OECD TP guidelines. This entails that the taxpayers have to file a Master File, A local file and certain taxpayers must also produce a CbCR.

## d) Tax Havens & Blacklists

According to CFC rules, an Israel person may be taxed on a proportion of certain undistributed profits when passive income received has been subject to an effective tax rate less than 15%.

## e) Advance Pricing Agreement (APA)

APA provisions are included under Sections 85A(d) and 158 of the Income Tax Ordinance. Both unilateral and bilateral APAs can be reached with the ITA. While there is no specific guidance on the content of an APA application, an initial APA request shall be sent to the TPD and will include:

- the essential facts;
- transfer pricing documentation;
- relevant documents, approvals, +opinions, declarations, estimates, and agreements;
- a description of the intercompany transaction(s); and

- the taxpayer's proposed consideration for the transaction(s), including the profit level margin.

No fee is charged by the ITA for an APA application. The TPD will then respond to the taxpayer with a request for the following data:

- information regarding comparable transactions;
- information regarding the chosen TP method;
- comparability factors and details regarding any adjustments made to the comparability factors;
- the reasons for choosing the selected method;
- the results of the comparables;
- the relevant range of values or the interquartile range and any conclusions drawn from the comparison;
- financial reports of both parties to the transaction for the previous three years; and
- any document or other detail deemed necessary for the ITA decision.

The TPD will then negotiate with the taxpayer and may request more documents, meetings, and site visits. The TPD has a 120 days' timeframe within which it must approve or reject an APA application, however a 60 days' extension may be granted where notice is given to the Tax payor. If the tax authorities do not issue their decision within the time limits provided, approval of the APA will be considered to have been given and the transaction subject of the APA will be deemed to be at arm's length. There is no specific guidance for a renewal procedure. In practice, the ITA supports APA renewals, however, the procedure is similar to the initial APA as described above.

### f) Audit Practice

Within the ITA is a dedicated Transfer Pricing Department (the "TPD"), which is responsible for performing audits and the economic analyses to determine the arm's length price for a taxpayer's controlled transactions. The TPD audits Israeli subsidiaries of multinational enterprises (MNE), permanent establishments (PE), and local corporations with subsidiaries outside of Israel, and has been given the full authority to review (and tax) previously approved assessments, and to reopen final assessments, which were approved up to three (3) years before their inspection. The TPD also gives guidance and instructions to local tax assessment officers ("AO") to screen and initiate audits on a wider level. In case of an audit by a local tax assessment officer, certain disagreements may be handed over to the TPD

## 3. Transfer Pricing Documentation

### a) Level of Documentation

A tax payor engaged in a cross-border controlled transaction is required to include in its annual tax return the foregoing mentioned Form 1385 describing the intercompany transaction and its nature, including references to its price and other relevant terms and conditions. Hence, the ta payor is expected to hold contemporaneous documentation, updated on an annual basis. Since, as noted above, by signing Form 1385 the taxpayer declares that the company is compliant with the arm's length principle and that it maintains up-to-date transfer pricing documentation (i.e., transfer pricing study, inter-company agreement and also, where applicable, a transfer pricing policy), it is advisable to have in place an updated transfer pricing study on an annual basis. In addition to preventing penalties and fines, holding a transfer pricing study and other related transfer pricing documentation shifts the burden of proof to the tax AO and enables the tax payor to hold an arguable position regarding any determination made by the tax AO concerning transfer pricing adjustments. Full documentation includes the following:

- Description of the principle inter-company transactions and the parties involved in these transactions, including a description of the management structure of the parties and functional organizational charts;

- Description of the business environment and the economic circumstances in which the parties operate;
- Functional analysis of the parties involved in the intercompany transactions (including functions performed, risks assumed and resources employed);
- Selection of the pricing method(s) and the reasons behind such selection;
- Economic analysis (determination of arm's length prices);
- The conclusions that may be derived from the comparison to uncontrolled comparable transactions. Additional documents that corroborate the data described above such as:
- intercompany agreements;

any disclosure made regarding the controlled transactions to any foreign tax authority including any request for an advanced pricing agreement (APA);

- a transfer pricing policy, if applicable;
- any differences between the prices reported to the foreign tax authority and the prices reported in the Israeli tax returns; and
- any existing opinions by the company's consultants, if such were given.

Furthermore, it shall be noted that since 2018 Israel took further actions and implemented Action 13 of BEPS. As a result, , in addition to the regular local file (i.e., the transfer pricing study) Israeli tax payors that are part of a multinational group will also be required to submit data at the corporate level, namely a Master File accompanied with related data of the multinational group. In addition, an Israeli tax payor who serves as the ultimate parent of a multinational group which consolidated turnover exceeds 3.4 billion new Israeli shekels (sum may be subject to amendments) will be bound to submit a country-by-country report (CbCR) as well.

### b) Industry Analysis

By identifying value drivers for the relevant industry, a first indication of the level of profitability common in the industry is being given.

### c) Company Analysis

A description of the management structure of the local entity, a local organisation chart, and a description of the individuals to whom local management reports and the country(ies) in which such individuals maintain their principal offices.

A detailed description of the business and business strategy pursued by the local entity including an indication whether the local entity has been involved in or affected by business restructurings or intangibles transfers in the present or immediately past year and an explanation of those aspects of such transactions affecting the local entity.

### d) Functional Analysis

In conducting a functional analysis, an assessment is made of the significant activities and responsibilities that are performed by the related parties relevant to the Intercompany Transactions under review, the tangible and intangible assets that are employed and the risks that are borne in undertaking the business activities. Such an assessment is consistent with the recommendations that have been made in the OECD Guidelines at paragraph 1.51.

### e) Choice of Transfer Pricing Method

The OECD methods are generally acceptable depending on the facts and the circumstances of the case. There is no hierarchy of methods. The following methods are accepted in the CIT Act:

- Comparable Uncontrolled Price Method
- Resale Price Method
- Cost Plus Method
- Transactional Net Margin Method
- Profit Split Method

If none of these methods is applicable, the tax payer may use another approach.

### f) Economic Analysis - Benchmark Study

Taxpayers are required to conduct a Benchmark study to determine the arm's length price of the transactions. Local comparables are strongly preferred but in certain cases international comparables can be used as well.

### g) Inter-company (IC) Legal Agreement

Although an Inter-company legal agreement formalizes the business and financial relationship between group entities, the legal agreements have a lower ranking since the OECD 2017 Guidelines made the ''conduct of parties'' the prevailing concept.

### h) Financial Statements

Taxpayers are required to disclose intra-company transactions in their Financial Statements.

### i) Production Process for TP Relevant Returns, Documents, Forms and Financials

In the chart below, the existence of the filing requirements with the details of which format is used, the latest filing date, notification requirement and its deadline, thresholds to be applied in case it exists, and the required languages are demonstrated. This information can be seen respectively for CIT, master file, local file, CbCR, local forms, annual accounts and segmented P&L documentations.

| | **Prepare or File?** | **Format** | **Deadline** | **Notification Deadline*** | **Threshold* (Yes/No)** | **Local Language (Yes/No)*(If "No", it can be filed in English)** |
|---|---|---|---|---|---|---|
| **Corporate Income Tax** | File | Local GAAP | Within 60 days upon request from tax authorities. | N.A. | No | No |
| **Master File** | N.A. | N.A. | N.A. | N.A. | N.A. | N.A. |

| | | | | | | |
|---|---|---|---|---|---|---|
| **Local File** | N.A. | N.A. | N.A. | N.A. | N.A. | N.A. |
| **CbCR** | N.A. | N.A. | N.A. | N.A. | N.A. | N.A. |
| **Local form X** | N.A. | N.A. | N.A. | N.A. | N.A. | N.A. |
| **Local form Y** | N.A. | N.A. | N.A. | N.A. | N.A. | N.A. |
| **Local form Z** | N.A. | N.A. | N.A. | N.A. | N.A. | N.A. |
| **Annual Accounts** | N.A. | N.A. | N.A. | N.A. | N.A. | N.A. |
| **Segmented P&L** | N.A. | N.A. | N.A. | N.A. | N.A. | N.A. |
| * Israel has signed the MCAA agreement for the filing of CBCR. | | | | | | |
| * Israel does not request as much and detailed information from smaller and less complex enterprises (SME's included) than it does from large and complex enterprises. | | | | | | |

### j) Mandatory Language

The documentation can be filed in English or Hebrew.

### k) Notification Requirement

The notification due date is December 31 of the following year after the tax year and/or the date in which the financial reports are to be filed. Upon the request of the Tax Authorities, taxpayer has to submit the documentation within 60 days. For detailed information, the amendment has not been published yet.

### l) Record Keeping

N/A.

### m) Penalties and Interest Charges

Currently, there is no specific penalties for transfer pricing, so the general penalties specified in ITO will apply. Penalties may be imposed on a tax payor for not preparing and submitting transfer pricing documentation on time or at all. The current legislation allows for 60 days from request by the ITA to present the documentation, however the AO usually ask for this to be more immediate, and suggested legislation is expected to shorten this period to 30 days. In any case, the lack of contemporaneous documentation at the time the tax returns were filed, is likely to shift the burden of proof to the tax payor, as mentioned above.