



Overview

Herzog Fox & Neeman, Taxand Israel

The Herzog Fox & Neeman “Herzog” transfer pricing team offers Israel’s most comprehensive guidance on international transfer pricing, helping clients avoid costly audits, disputes and penalties. Herzog is the only law firm in Israel that provides full transfer pricing services; the fact that under Israeli law our clients’ matters remain privileged and confidential, serves as an additional advantage of planning your international structure together with us. The Herzog practice is experienced with planning, documenting, litigation, APAs and MAPs, and provides the full range of services to its clients, focusing on the legal, economic, and business related aspects of the client’s tax structure and supply chain, employing innovative solutions. Herzog represents clients in both inbound and outbound transactions, in restructuring, audits, and of course the preparation of the required documentation in accordance with the changing regulatory environment, including the implementation of FAR, DEMPE and Value Chain Analysis. Each Master File, Local File, intercompany agreement and transfer pricing study prepared, is given the full attention of the practice leader partner, attorney and economist Eyal Bar-Zvi.

Services include:

- ❖ Transfer pricing planning
- ❖ Master File, Local File, and transfer pricing studies
- ❖ Intercompany agreements
- ❖ Transfer pricing audits and litigation
- ❖ Transfer pricing policies (SOP)
- ❖ Advance pricing agreements (APA)
- ❖ Mutual agreement procedures (MAP)
- ❖ Transfer pricing implementation
- ❖ Intercompany finance
- ❖ DEMPE and profit split analyses
- ❖ Transfer pricing M&A Due Diligence

General: Transfer Pricing Framework

Israel’s transfer pricing regime is regulated under Section 85A of the Israeli Tax Ordinance and the Regulations (Determination of Market Conditions) thereunder (the “Israeli TP Legislation”). Section 85A introduces the arm’s-length principle by asserting that an international transaction between parties with ‘special relationships’ should be taxed in line with the appropriate market prices.

The scope of the Israeli TP Legislation is formally limited to cross-border transactions in which a special relationship exists between the parties to the transaction (i.e., related parties), however recent case law has expanded this scope also to non-related parties, and the ITA enforces the arm’s length principle also in transaction within Israel. The Israeli TP Legislation

covers all types of transactions, including: services (e.g., R&D, manufacturing, marketing etc.); distribution; the use or transfer of intangible assets (e.g., know-how, patents, trade names or trademarks); and financing transactions (e.g., loans, capital notes, guarantees and captive insurance).

As noted, the ITA unofficially implements the arm’s length principles with respect to domestic related-party transactions, for example when involving Israeli entities that receive tax benefits (e.g. preferred technological enterprise). Additional guidance is provided by ITA circulars, such as with regard to safe harbours.

Accepted Transfer Pricing Methodologies

The Israeli TP Legislation mostly incorporates the OECD Transfer Pricing Guidelines for Multinational Organizations “OECD Guidelines” approach towards determination of the correct analysis methods for examining a multinational transaction between related parties. It should be noted, however, that certain tax circulars offer a ‘safe-harbor’ mechanism with specific margins.

The Best Method rule, which is set out in the Israeli TP Regulations, requires that the arm’s length result of a controlled transaction, should be determined under the method that, given the facts and circumstances, provides the most reliable measure of an arm’s length result.

The following hierarchy should be employed in implementing the Best Method rule:

- 1) The preferred method is the Comparable Uncontrolled Price or Transaction Method “CUP/CUT” method because it can produce the most accurate and reliable arm’s-length results.
- 2) When the CUP/CUT method cannot be used, then one of the following methods should be employed:
 - Resale Price Method (RPM);
 - Cost Plus Method;
 - Profit Split Methods (comparable or residual); or
 - Transactional Net Margin Method (TNMM)
- 3) If none of the above methods can be applied, other methods that are more suitable under the circumstances should be used. However, this should be justified both economically and legally, and the application of a different method cannot normally be justified when one of the above-prescribed methods is applicable.

When applying a certain transfer pricing method, an adjustment is sometimes required to eliminate the effect of the difference derived from various comparison characteristics between the controlled and comparable uncontrolled transactions.



According to the Israeli TP Legislation, a cross-border controlled transaction is considered to be at arm's length if, following the comparison to similar transactions, the result which has been obtained does not deviate from the results of either the full range of values derived from comparable uncontrolled transactions when the CUP/CUT method is applied (under the assumption that no comparability adjustments were performed), or the interquartile range (the values found between the 25th and 75th percentiles in the range of values) when applying other methods.

Transfer Pricing Documentation Requirements

As with most OECD countries, Israeli companies and/or PEs are required to meet the local transfer pricing requirements, which include to hold an intercompany agreement as well as a transfer pricing study.

On September 7th, 2022 the Finance Committee of the Knesset (the "Israeli Parliament") finalized the approval of changes to the Israeli TP Regulations to include Master File and Country by Country Report "CbCR" concepts, as well as updated other reporting (Local File) obligations in Israel.

TP documentation is required to be submitted within 30 days of request by the ITA, as customary in other jurisdictions. In this respect, the ITA expects the TP documentation to be in place and updated periodically (i.e. annually), as the TP study is the basis for annually filing Form 1385 (and 1485, if relevant), and Form 1585, as will be described hereinafter.

In addition to the previous requirements in the TP documentation that generally align with the OECD Local File, the following details were added as required in each TP study:

- ❖ A table depicting the senior level job descriptions and group / company structure, without the names. However, the companies will also be required to detail where the senior officials are physically located;
- ❖ A list of the entities' competitors;
- ❖ A description of the main agreements.

Moreover, as mentioned above, the Finance Committee also published requirements regarding Master File. The Finance Committee settled that the threshold will be NIS 150 million. This requirement applies to an Israeli parent as well as to an Israeli subsidiary even if the parent company's jurisdiction does not require a Master File.

The Master File template generally follows the OECD Master File template, however with some adjustments for Israeli companies, which widen the reporting scope, including but not limited to: (i) the group's organizational charts (indicating geographic location of employees); (ii) description of the group's service agreements; (iii) description of changes to the group's shareholders; (iv) description of the supply chain surrounding the group's five largest revenue generating products or services; etc.

In February 2025 the ITA published Circular 01/2025 providing additional guidance regarding Country-by-Country Reporting

obligations, filing mechanics and thresholds applicable under Sections 85B and 85C of the Ordinance. All MNE groups meeting a consolidated revenue threshold of NIS 3.4 billion need to submit such report. The guidance covers the timing of the requirements as well the method of submission. This includes that in order to submit a CbCR in Israel, registration is required in a dedicated Internet system. This system may be used by Israeli ultimate parent entities submitting their CbCR in Israel as well as foreign ultimate parent entities that wish to submit its CbCR in Israel. The guidance also notes that an Israeli ultimate parent entity may choose to submit the CbCR in another country where a group entity exists. In this case, the ultimate parent must report on where the CbCR is submitted.

Lastly, the guidance provides that where a constituent entity resident in Israel is not the ultimate parent entity, it must report on the country in which the CbCR is submitted together with identifying details including the name of the entity, the number of the entity, the name of the MNE group, the name of the ultimate parent entity, tax identification number, and contact information.

A taxpayer engaged in a cross-border transaction with related parties is required to include in its annual tax return a special form, Form 1385, describing the transaction and its nature, including references to its price and other relevant terms and conditions, as well as additional details regarding the implemented transfer pricing method and the profitability rate used for the transactions. As of December 23, 2022, this form has been amended and now includes a requirement to disclose how the transfer pricing was determined, i.e. in accordance with the local safe harbor rules or in accordance with an existing transfer pricing study, by declaring whether the tax payer holds a transfer pricing study. The form is signed similar to an affidavit, with the signing person declaring that all the information included in the form is "correct, complete and accurate". A company which does not hold a complete transfer pricing study can either declare so – and "invite" an audit, or – if it states that it does while it does not actually hold a complete contemporaneous transfer pricing study, it will be subject to fines and potential criminal liability for making a false representation to the tax authorities.

We note that financial transactions are reported on a separate form, form 1485; and that an additional form providing group data in order to determine Master File and CbCR requirements, Form 1585, must be filled as well.

Local Jurisdiction Benchmarks

The Israeli TP Regulations do not require only local jurisdiction comparables, as those are mostly scarce. Generally benchmarks on the basis of Israeli comparables in addition to either North American comparables or developed European nation comparables are utilized.



Focus on Financial Transaction in Israel

Under Israeli transfer pricing rules, intercompany financial transactions are subject to the arm's length principle and an increasing focus by the Israeli Tax Authority (ITA). Taxpayers are required to demonstrate that the terms and conditions of the financing arrangement are consistent with those that would have been agreed between independent parties under comparable circumstances. In practice, similar to the OECD Guidelines, the ITA places significant emphasis on the economic substance of the transaction, including the commercial rationale for the financing, the borrower's capacity to service the debt and the allocation of risks between the parties. Accordingly, a robust transfer pricing analysis typically includes an assessment of the borrower's creditworthiness, an evaluation of the amount of debt that could reasonably have been obtained from third-party lenders, and benchmarking of the interest rate and other key terms against comparable market transactions.

Intragroup financing arrangements are required to be disclosed and documented as part of the annual transfer pricing compliance framework, including on Form 1485, which is an annual tax return appendix that requires reporting of international related-party financial arrangements. Given the increasing focus of the ITA on financing transactions, taxpayers are expected to maintain contemporaneous documentation supporting both the pricing and characterization of such arrangements.

A notable instrument increasingly utilized by Israeli companies, when parent entities fund subsidiaries, is the capital note. A compliant capital note under Israeli tax principles must be classified as such prior to the transfer of the funds and is subject to specific characteristics such as a minimum term of five years, non interest bearing, etc. Given the extensive use of capital notes by Israeli multinational groups, the ITA has increasingly focused on whether an instrument genuinely satisfies the legal and economic characteristics of a capital note or whether it should instead be recharacterized as a loan, as was adjudicated also by relevant case law.

In addition to transfer pricing considerations, taxpayers must also consider the broader Israeli tax framework governing financing arrangements, including interest deductibility rules, withholding tax implications and general anti-avoidance principles, all of which may affect the ultimate tax treatment of intragroup financing irrespective of the arm's length nature of the pricing.

Advance Pricing Agreement "APA"/Bilateral Advance Pricing Agreement "BAPA" Overview

APAs are not common in Israel, although they exist. In certain cases, settlements to close audits can be carried forward as part of an APA. However, settling a past audit cannot guarantee the same treatment in the future, unless a formal APA is reached.

Transfer Pricing Audits

There is a dedicated Transfer Pricing Department "TPD" within the ITA, which is responsible for performing audits and economic analyses to determine the arm's-length price for a taxpayer's transactions. Further, the TPD has been given full authority to review (and tax) previously approved assessments and to reopen final assessments that were approved up to three years before their inspection. The TPD also gives guidance and instructions to local tax-assessing officers to screen and initiate audits on a wider level. In the event of an audit by a local tax tax-assessing officer, certain disagreements may be handed over to the TPD.

In Israel, the tax authorities' transfer pricing unit audits both Israeli subsidiaries of multinational enterprises and local corporations in all matters related to transfer pricing. Taxpayers can dispute the proposed transfer pricing adjustments of the tax authorities by means of appeals, courts and through the use of treaties (where relevant).

Because of the nature of the Israeli market, the ITA gives special attention to R&D services provided by Israeli subsidiaries and matters relating to intangibles, which may also involve governmental support. The ITA also focuses its audits on the restructuring of functions, assets or risks and on the distinction between marketing services and distribution activities carried out in Israel by multinational enterprises.

The ITA Income Tax Circular No. 8/2025

The ITA issued Income Tax Circular 8/2025, establishing a more structured transfer pricing framework for multinational groups with Israeli R&D centers as well as multinationals which purchase Israeli companies and relocate the acquired company's IP. The Circular enhances tax certainty by formalizing acceptable cost-plus remuneration models, introducing approval thresholds for transfer pricing adjustments, and creating a dedicated ruling mechanism for post-acquisition IP transfers, including a formula to calculate the ITA's potential baseline position as to the value of such IP, and business restructurings. The guidance is intended to promote consistency and reduce transfer pricing controversies.

Evidence-gathering process

The ITA does not usually interview persons outside the company undergoing an audit, although this is not prevented by legislation. It is common, however, to allow the professionals who act as consultants to the company to be interviewed by the ITA with regard to their work, and to present them to the ITA as part of a 'hearing' held for the



company. These meetings occur both prior to and following the issuance of a transfer pricing tax assessment.

With regard to intra-group information requirements, the ITA may request intra-group information even if it is held outside Israel. If the company fails to present the requested information, it is likely to be viewed negatively throughout the process, including (potentially) in court, thereby preventing the company from providing the information at a later stage.

The Burden of Proof in Transfer Pricing: Theory versus Practice

According to the Israeli transfer pricing rules, the initial burden of proof lies with the taxpayer and shifts to the ITA once a transfer pricing study has been submitted for assessment. Based on Tax Circular 1/2020, the rules for shifting the burden of proof have been aggravated as the filing of a transfer pricing study alone does not necessarily shift the burden of proof to the ITA where there is a disagreement on the factual background, the method chosen, or when the submitted transfer pricing study is incomplete.

Non-recognition - In rare cases where a transaction between related parties lacks any commercial rationale (ie, the same transaction under similar economic circumstances would not have been agreed between non-related parties), the ITA may choose not to recognize the transaction in its original form and may treat it as an entirely different type of transaction – a type of transaction that, in its view, would reflect the business reality of the transaction in a more adequate manner. In those cases, the burden of proof lies with tax authority to justify its standing for non-recognition.

Transfer Pricing Penalties

Penalties may be imposed on a taxpayer for not preparing and submitting transfer pricing documentation on time or at all. In addition to preventing penalties and fines, holding a transfer pricing study in most cases shifts the burden of proof to the ITA and enables the taxpayer to maintain an arguable position regarding any determination made by the ITA concerning transfer pricing adjustments.

The ITA is entitled to impose secondary adjustments and, in fact, does so in practice. For example, if the taxpayer made an adjustment (the first adjustment) according to its transfer pricing policy and determined its profit to be a certain percentage (based on its transfer pricing study or transfer pricing range), and the ITA disagreed with its policy or benchmark analysis, the ITA could, in that case, carry out a secondary adjustment.

Transfer pricing specific penalties are uncommon in Israel and, although discussed as a possibility, have not yet been enacted. Adjustments, linkage, interest and statutory fines on assessments, which already appear in the Israeli Tax Ordinance, currently apply to transfer pricing as well.

In this respect, it is also important to note that, in the past, ITA officials have indicated that submitting a Form No. 1385 that includes a personal affidavit by a company's officer subsequently found to be erroneous can lead to criminal liability, although such liability has not been imposed to date.

Local Hot Topics and Recent Updates

As is the case in many jurisdictions worldwide, transfer pricing remains a focus of the Israeli Tax Authority and a constantly evolving field. The following is a small sample of the many recent updates:

Evolving Business Models and the Strain on Traditional Transfer Pricing Methods

Business innovation is rapidly outpacing the tax frameworks built to price it. The traditional TP boundary between "routine" service providers and risk-bearing entities is eroding. Modern commercial structures increasingly blend service provision with performance-tied upside, co-investments, or cost-plus models carrying economic exposure. Once routine revenue is entangled with entrepreneurial outcomes, static TNMM or cost-plus analyses fail to reflect economic reality.

Simultaneously, a gap is widening between formal TP structures and actual operations. As local teams organically scale and assume strategic responsibilities, tax authorities are aggressively auditing this misalignment by scrutinizing actual decision-making and value creation rather than accepting paper contracts at face value.

This friction is highly visible in Israel's tech sector, where routine cost-plus R&D centers evolve into key decision-making hubs without updated TP structures.

Furthermore, the increasing relocation of Senior/Strategic personnel is raising questions regarding the point at which such relocations constitute a significant change in the business or potential move of function as well as the appropriate treatment of option plans and vesting cycles. As such, this is an area increasingly scrutinized by the ITA.

Finally, due to the increased strain on traditional models, we have seen an increase in audits leading to MAP procedures in which each authority raises significant claims that highlight this ever evolving gap between traditional models and actual operations.

The Philip Morris Case – Israeli Subsidiary can be Served on behalf of its Foreign Parent

The March 2025 ruling in the Philip Morris case was a ruling in a civil procedure matter with profound impact on transfer pricing. The case centered on an alleged violation of competition laws by a Phillip Morris entity in Switzerland together with the group's ultimate parent entity in the United States. The lawsuit was brought locally against Philip Morris' entity in Israel as a representative of its Swiss parent and the



group ultimate parent entity. Philip Morris Israel contended that it is not the appropriate party to be served and should not be a party to the lawsuit. In its ruling the supreme court ruled that as a fully owned subsidiary engaging in the same field of business, the lawsuit can be served to Phillip Morris Israel. This ruling raises significant transfer pricing questions as this additional risk undertaken by Israeli subsidiaries must be considered when settling on an appropriate compensation model.

SentinelOne Reaches a Landmark Settlement with the ITA over Israeli R&D Center IP

In January 2026, SentinelOne, Inc. entered into an assessment agreement with the ITA, resolving a major TP dispute over its Israeli subsidiary’s IP valuation. Covering fiscal years 2021–2025, the settlement targets a classic tech lifecycle: a startup that evolved post-funding into a key group service provider.

Notably, the dispute was resolved through a bilateral APA process involving both the IRS and the ITA, underscoring how multinationals are increasingly relying on bilateral APAs to resolve the very valuation disputes the ITA now hopes to preempt via Circular 8/2025.

The case stands as a stark example of how shifting functional profiles can trigger massive cross-border tax disputes that require years of bilateral negotiation to resolve.

Coca-Cola Ruling Expands the Arm’s Length Principle

In an October 2024 ruling, the courts ruled in favor of the ITA in a precedent setting case against the Central Bottling Company (the “Israeli Bottling Company” or “IBC”).

The ITA argued that Coca-Cola’s business activities within Israel, through a privately held unrelated entity, the IBC, Coke’s exclusive manufacturer and distributor in Israel, benefitted from special relationships that went beyond the contractual or legal obligations of a simple buyer-supplier relationship and as such should be subject to transfer pricing regulations.

The Coca-Cola concentrate is central to IBC’s operations, and this dependency, argues the ITA, gives Coca-Cola significant influence over IBC’s pricing strategies, market positioning, and even supply chain decisions. Further, the ITA claimed that part of the payments should be classified as consideration for the license to use Coca-Cola’s trademarks and intellectual property in marketing Coca-Cola drinks in Israel, as well as for example knowhow related to the manufacturing process. The court determined that, “In exchange for such a strong trademark with an accepted global reputation, it is customary to pay royalties.”

Documentation threshold

Master file	Group revenue exceeding NIS 150M
Local file	No minimum
CbCR	Group revenue exceeding NIS 3.4B

Submission deadline

Master file	Should be prepared prior to filling of tax return, submission upon request.
Local file	Should be prepared prior to filling of tax return, submission upon request. Necessary to submit affidavit (Form 1385) with tax return indicating if the local file is in place.
CbCR	Either submission or notification of jurisdiction of submission when filling tax return.



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