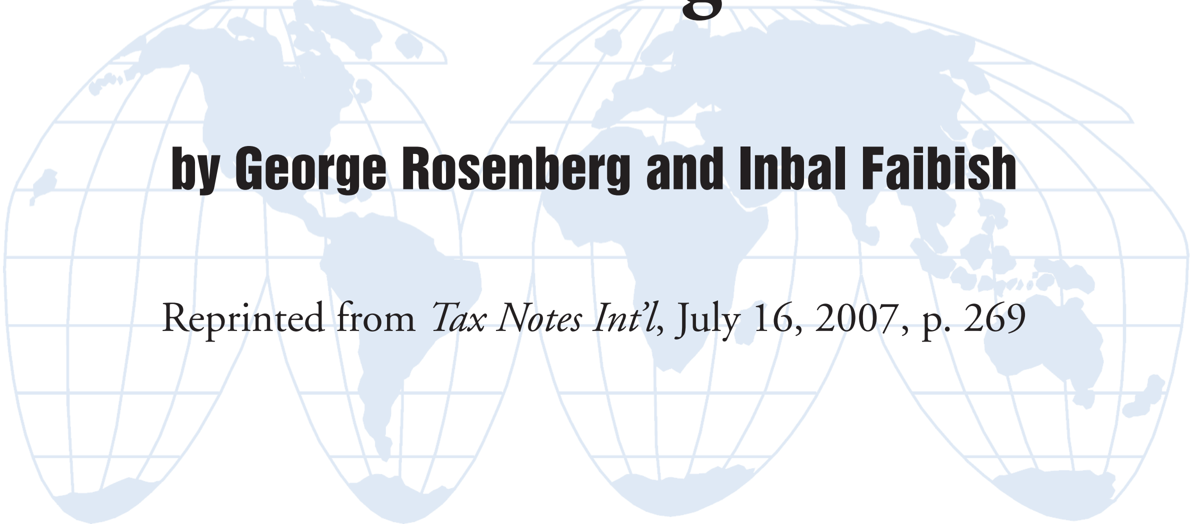
taxanalysts
Respectfully disagreeable since 1970.

tax notes international

Volume 47, Number 3 ■ July 16, 2007

Transfer Pricing in Israel



by George Rosenberg and Inbal Faibish

Reprinted from *Tax Notes Int'l*, July 16, 2007, p. 269

(C) Tax Analysts 2007. All rights reserved. Tax Analysts does not claim copyright in any public domain or third party content.

Practitioners' Corner

Transfer Pricing in Israel

by George Rosenberg and Inbal Faibish

George Rosenberg is a senior partner of Rosenberg, Keren-Polak & Co. in Tel Aviv, and Inbal Faibish is an associate with Rosenberg, Keren-Polak & Co. in Zurich.

The continuing growth of international global companies and international commerce, together with Israel's high tax rates, may create an incentive to shelter income from tax by directing profits and income out of Israel. To address those problems, and in keeping with worldwide reforms,[1] Israel recently established transfer pricing provisions restricting the freedom of operation of individuals and companies.

Transfer pricing in Israel was introduced by major tax reform legislation that came into force on January 1, 2003. The legislation added a new section to the Israeli Tax Ordinance[2] that provided that when the price or conditions of a transaction are set because of the existence of special relations between the parties that result in lesser or larger profit than would have been had the price been fixed between nonrelated parties (that is, the market price), the price of the transaction will be deemed to be the market price and not the price fixed by the parties.

The Income Tax Regulations (Assessing Market Conditions) 2006 (the regulations), which were published and became effective on November 29, 2006, define special relations and provide tools for assessing transactions and their market price.[3] Currently, every transaction that fulfills the prerequisites detailed below is subject to the regulations and therefore to an assessment of its price and terms.[4]

The regulations apply only to international transactions, which are defined as transactions between parties having special relations in which at least one party is foreign resident. Special relationships can also exist among individuals with family connections or a controlling relationship. "Controlling relationship" means as at least 50 percent control, taking into account holdings, some assets held in trusts, and future and current cooperations.[5]

---

[1]*See Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* (OECD, 1995). For more examples, see reports of OECD member countries and observers (*available at* http://www.oecd.org/document/25/0,2340,en_2649_33753_37837401_1_1_1_1,00.html and http://www.oecd.org/findDocument/0,2350,en_2649_33753_1_119663_1_1_37427,00.html) and Convention 90/436/EEC on the Elimination of Double Taxation in Connection With the Adjustment of Profits of Associated Enterprises, OJ L 225 (Aug. 20, 1990).

[2]Section 85A.

[3]Unless indicated otherwise, all sections below refer to sections in the regulations.

[4]As a transitional provision, a market analysis made in this respect in the two years preceding the establishment of the regulations will be accepted subject to the analysis being concluded in accordance with OECD or OECD member state guidelines (section 6).

[5]Section 1.

(C) Tax Analysts 2007. All rights reserved. Tax Analysts does not claim copyright in any public domain or third party content.

The regulations portray the methods for assessing and comparing the price and terms of the transaction with the market price or market terms. They require a comparison between:

- the price of the examined transaction and the price of a similar transaction;
- the profitability or loss of the transactions; or
- the division of the profits and losses between the parties.

The regulations also authorize the Tax Authority to use any other adequate method.[6] Transactions must be reported in the taxpayer's annual tax return.

The transaction price or conditions must be compared with those of similar transactions made during the three tax years preceding the transaction.[7] The transactions' determined price, profitability, and the division of profit and losses will comprise the average of all those items in similar transactions.[8] All similar transactions made by the same parties under similar terms in the three years preceding the transaction are regarded as one transaction, unless there is evidence of substantial differences between the transactions or the market has undergone or is expected to undergo major changes.[9]

The Tax Authority carries the burden of proof to show that the pricing or terms of a transaction are different from the market price or the market terms. To do so, the Tax Authority can require the Israeli resident taxpayer to provide within 60 days all documents relevant to the transaction and to the determination of the price. Those documents must include:[10] (1) legal and financial information about the taxpayer; (2) legal and financial information about the other parties to the transaction, their residency, and the special relations between them and the taxpayer; (3) information about the transaction, including assets, prices, loans, guarantees, and credit terms; (4) information on the economic environment, including expected future changes; (5) review of the industrial and economic situation and its risks; (6) information on the use of intangible assets, directly or indirectly in connection with the transaction; (7) information on past and future transactions between the taxpayer and each party, including loans, payment of management fees, partnerships, joint ventures, gifts, guarantees, trusts, and any other agreements; (8) detailed characteristics of similar transactions in the same or related fields, and the assessment method chosen for those transactions; and (9) details about any sort of reporting (for example, partial or full reporting in a preruling procedure) in a foreign country, including the method and details of the report, as well as the reasons for any difference between the details reported in Israel and the details reported in the foreign country.

The taxpayer must provide the Tax Authority with documents necessary to verify the information given, including reports submitted to a foreign country and documentation of any professional advice that was given in Israel or abroad.[11]

To avoid assessment of past transactions, a taxpayer may undergo a preruling procedure, in which the Tax Authority must answer the preruling request within 120 days of receiving requested documents.

A one-time international transaction may be exempt from the regulations and assessed like a regular transaction between nonrelated parties. The Tax Authority would require documentation to include only items 1 through 7 above; documentation of advice, contracts, and information provided to other countries is unnecessary.[12]

[6] Section 2.

[7] Section 3(1).

[8] Section 3(3).

[9] Section 3(2).

[10] Section 5(a).

[11] Section 5(b).

[12] Section 4.

(C) Tax Analysts 2007. All rights reserved. Tax Analysts does not claim copyright in any public domain or third party content.