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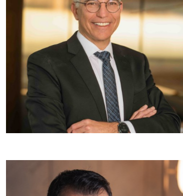

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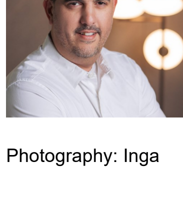

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PUBLICATION OF A POSITION PAPER BY THE ISRAEL TAX AUTHORITY–

THE IMPOSITION OF SURTAX ON EMPLOYEE STOCK OPTIONS UNDER THE CAPITAL GAINS TRACK – EROSION OF THE TAX BENEFIT

The Israel Tax Authority (“the ITA”) recently published Position Paper No. 05/2025, concerning the taxation of employee stock options. The Position Paper is intended to clarify the ITA’s position regarding the application of surtax on high earners’ income sourced from the exercise of employee stock options, pursuant to the provisions of section 102 of the Income Tax Ordinance [New Version], 1961 (“the ITO”). This entails a substantive and important update, that is of particular relevance for employees and high-tech entrepreneurs holding stock options under the track specified in section 102 of the ITO, and who expect to enjoy a tax benefit in the form of capital gains taxation at the time of exercise.

As published by us in the past, with effect from 1 January 2025, additional surtax in the rate of 2% is imposed on income generated from capital sources that exceeds the annual ceiling of NIS 721,560 (as of 2025). The foregoing, in addition to the surtax that applies pursuant to section 121B(a) of the ITO in the rate of 3% that is imposed on all chargeable income exceeding the annual ceiling.

Within the ambit of the Position Paper, the ITA clarified its stance, whereby section 102 employee stock options that enjoy a capital gains tax rate of 25% (28% with the added surtax according to section 121B(a) of the ITO), additional surtax in the rate of 2% will also apply, the foregoing with respect to the capital gains component deviating from the annual ceiling.

It should be noted that the Position Paper represents the ITA’s position only with regard to its interpretation of the provisions of the law. As is known, interpretation of the law and its manner of implementation by the competent authority are not binding on the court when it comes to examining the matter. Accordingly, in our view, an in-depth legal analysis of the provisions of the relevant sections of the law may certainly lead to a different interpretation.

THE GOTTEX GROUP –

HOW DID A DEBT OF HUNDREDS OF MILLIONS BECOME A TAX - EXEMPT DIVIDEND – BORDERING ON CLEVER AND LEGITIMATE TAX PLANNING AND AN ARTIFICIAL TRANSACTION

A ruling rendered by Judge Yardena Seroussi in the Tel Aviv District Court was recently published in a case concerning the Gottex Group, which holds rights in many leading fashion brands, including Zara, Pull & Bear and Bershka. The ruling constitutes an important milestone in interpretating tax laws, and particularly with regard to distinguishing between legitimate tax planning and an artificial transaction. Due to the importance of the matter, we will firstly review and summarize the facts of the ruling that are relevant for our purposes.

Over the years, the controlling shareholders and various companies within the Gottex Group took out loans from Gottex Swimwear Brands Ltd. (“Swimwear”), totalling roughly NIS 309 million. At the end of 2012, the aforesaid debt was assigned to Swimwear’s parent company, F. Findings Realities B.V., domiciled in Holland (“Findings”). Following assignment of the debt, Findings became the debtor vis-à-vis Swimwear, its subsidiary as aforesaid (at the same time, Findings obtained the right to demand repayment of the debt from the controlling shareholders and other companies within the Group).

At the beginning of 2013, Findings sold its holdings in Swimwear to Gottex Brands Holdings Ltd. (“Holdings”), another Israeli company within the Group, in consideration for roughly NIS 491 million. In practice, no moneys were transferred between the parties to the transaction. Thus, an amount of NIS 182 million was given as a loan from Findings to Holdings, and an additional NIS 309 million was transferred by way of assignment of Findings’ debt vis-à-vis Swimwear to the purchaser, Holdings. In view of this, following the transaction, Holdings became the debtor vis-à-vis Swimwear, while simultaneously also becoming its new parent company.

The following stage in the plan also occurred during 2013, when Swimwear distributed a dividend to its new parent company - Holdings, in the sum of NIS 319 million. Accordingly, most of the amount of the dividend that was distributed (NIS 309 million), was not transferred in cash, but rather by closure of inter-company debt. For tax purposes, distribution of the dividend was classified as a tax-exempt distribution, since it concerned a dividend distributed between Israeli companies.

The tax advantages of the move are clear - if Swimwear would have forgiven the debt against distribution of an inter-company dividend to its former parent company, Findings, a Dutch company, it would have been obliged to withhold tax at source in Israel in the rate of 5%. On the other hand, from the moment that the holding in Swimwear and the debts owing to it were assigned to an Israeli resident company, the debt could have been written off against the tax-exempt dividend, and so avoid the payment of tax and its withholding at source. Likewise, in this way, a balance in the original price of NIS 491 million for Swimwear’s shares “was created”, such that any future sale of those shares in consideration for up to NIS 491 million will not attract tax in Israel.

The assessing officer’s position regarding the move was that the inter-company debt balances, as stated above, constitute withdrawals by the controlling shareholders in the Group, which they withdrew from the companies in the Group as they saw fit, without returning the moneys taken by them, and that they engaged in an artificial transaction. It was therefore alleged that withdrawal of the moneys by the controlling shareholders and related parties should be classified as a dividend that is subject to withholding tax at source in the rate of 30%. Moreover, the assessing officer demanded that a fine be imposed for the failure to withhold tax at source in the rate of 15%, pursuant to the provisions of section 191A of the ITO. On the other hand, the Group’s legal counsel argued that the structural change, in the various stages, constitutes a legitimate business move that was done entirely for economic motives.

Within the context of her ruling, Judge Seroussi clarified that the business move of concentrating the loans in one place by Findings, in and of itself, could have been deemed a move for a business reason. However, it was held that the cumulative actions carried out by the companies in the Group consecutively, attest to the existence of an artificial transaction. It was thus held that tax should be withheld at source for the dividends that were distributed and that the new original price of Swimwear’s shares in the sum of NIS 491 million should not be recognized.

Nonetheless, the court accepted the Gottex Group’s position with regard to the tax rate that should be applied to the debt balances of the Group vis-à-vis Swimwear, and held that there should be withheld tax at source in the rate of 5%, the foregoing based on the duty to withhold tax at source vis-à-vis Findings (the Dutch company), which is entitled to the dividends that were received. In this regard, the court made a distinction between a pipeline company whose entire purpose is to transfer dividends up the chain and does so automatically on the strength of various agreements, and a holding company that is not obliged to transfer moneys received by it and has independent and separate legal capacity. In light of the foregoing, it was held that Findings is not a pipeline company, but rather an active holding company, which holds additional companies in the Group, and thus is entitled to the dividends so distributed.

It should be borne in mind that the court rejected the assessing officer’s position, who sought to disregard completely the legitimate business activities carried out by the Gottex Group with respect to organizing the loans, and incorporation of the holding companies. It should be mentioned, that attending to organizing the loans and chain of activities over a relatively short period of time, made it easy for the assessing officer to point out and convince the court that this speaks of one complete and organized move, that was designed for the purpose of reducing tax. Spreading the activities over a longer period of time, while performing them for clear business reasons and out of evolving business needs, could have strengthened the Gottex Group’s position in this respect.

THE DIGITAL REVOLUTION IN OBTAINING TAX CREDITS FOR DONATIONS –

TRANSITION TO ONLINE REPORTING

As is known, section 46 of the ITO provides that a donation to a public institution that complies with the criteria specified in the ITO, confers on the donor a tax credit in the rate of 35% of the amount donated, in the case of an individual and 23% (the prevailing corporate tax rate) of the amount donated, in the case of a corporation, the foregoing subject to the restrictions as prescribed in the section.

Over the years, allegations were raised contesting abuse of this tax credit, the foregoing both on the part of donors and public institutions. Accordingly, during the latter part of 2013, a committee was established, headed by (Retired) Judge Sara Frish, which examined the standard and criteria by which public institutions could obtain approval for receiving tax credits in respect of donations.

Moreover, during 2024, the ITA announced its intention to oblige public institutions holding approval pursuant to section 46 of the ITO, to issue receipts to donors via the ITA’s digital donation system, the foregoing effective as of January 2025. Connecting to the aforesaid system was supposed to have been done using dedicated software for issuing receipts in respect of donations that facilitated interfacing with the system or via a dedicated mobile application to be developed by the ITA. Likewise, it was published that donors wishing to exercise their entitlement to a tax credit for donations made by them could do so by means of online tax reconciliation, without having to maintain and present physical receipts for the donation, the foregoing, provided that the public institution is interfaced with the new digital donations system. The then prevailing security situation led the Director of the ITA to defer the date for implementing the change to 1 January 2026.

Recently, the ITO published a supplement to the Income Tax Circular on this subject. According to the supplement, all non-profit associations (amutot) holding approval pursuant to section 46 will be required, as of 1 January 2026, to report on all donations (and cancelled donations) received by them through the ITA’s new digital donations system. The system reporting will be done automatically by means of the software that was used for issuing receipts for the donations, provided that the software is interfaced with the system and a super authorized agent is appointed for the digital services to be provided by the ITA. The digital system will automatically allot a unique registration number for every receipt that is issued for a donation that is reported by the public institution. Public institutions that will not be interfaced with the new system might forfeit their right to obtain approval pursuant to section 46 of the ITO or be considered as not having managed their books of account as required by law.

IKEA IN THE FOOTSTEPS OF COCA-COLA –

THE COURT QUALIFIES PAYMENTS TO AN INTERNATIONAL COMPANY AS ROYALTIES

In the tax newsflash published by us in November 2024, we extensively reviewed the ruling rendered by Judge Magen Altuvia in the Coca-Cola case, in which it was held that payments paid to an international company within the Coca-Cola group constitute royalties (and not payments for services), a significant qualification that led to the imposition of a duty to withhold tax at source. The ruling published on 7 August 2025, in the case of Northern Birch Ltd., the franchisee of IKEA in Israel, is following in the same footsteps. In so doing, Judge Altuvia ruled that also payments made by the Israeli company to IKEA Global in the rate of 3% of its sales, for use of the brand, trademark and unique retail method, constitute royalties and not payment for services. The court emphasized that the core value for the franchisee stems from intellectual property, the brand and IKEA Global’s know-how, and that the services that were provided, to the extent so provided, were negligible and trivial.

It should be mentioned that the discussion in the Coca-Cola case is expected to reach the doorway of the Supreme Court, which has been asked to decide on the appeal that was filed in the matter. The rule of law that will be determined on this issue will, as aforesaid, have significant lateral tax implications that will affect many diverse multinational groups operating in Israel. We will naturally monitor all developments and update you accordingly.

* The newsflash is intended to provide subscribers with general information only and should not in any way be regarded as firm professional advice and/or a definitive legal opinion.

Our firm continues to remain at your disposal for any additional questions or clarifications regarding the matters discussed above or in general, and we wish you and your loved ones peaceful and tranquil days.

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