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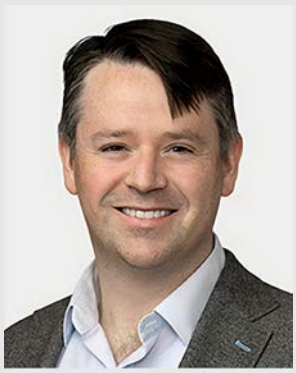

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In this article, Mezei and Craig analyze the Israel Tax Authority's practice of inferring taxable intangible-property transfers from post-acquisition changes in the target's functions, assets, and risks. They argue that while such changes can assist in identifying and pricing specific intercompany transactions, they should not serve as a shortcut that results in imputing enterprise-level value transfers based on post-acquisition outcomes.

Over the past decade, Israel has consistently ranked high on the global list of startups per capita.[1] Some commentators now rank Israel at or near the top of the list for so-called unicorn startups — privately held companies valued at over $1 billion.[2] Startup exits — in which founders and other early investors sell the company for cash, stock in a larger company, or a combination of the two — are common for Israeli companies.[3] In 2025 Google's parent company, Alphabet, agreed to pay $32 billion to acquire Wiz, a cloud cybersecurity company.[4] The deal has been widely reported as the largest Israeli startup exit to date (and Google's largest announced acquisition).[5]

The foreign acquirers of Israeli startups are typically U.S.-based multinational enterprises. The Israeli targets are usually in the technology or medical device sectors. Many of the targets are not yet profitable. Some are even pre-revenue. As a result, a meaningful portion of the acquisition price frequently reflects expected future business potential rather than current operating income. Whether (and how) Israel can tax that acquisition value, which includes the acquirer's present-value assessment of anticipated future profits, lies at the center of recent and ongoing disputes in which the Israel Tax Authority (ITA) has attempted to tax perceived value migration after an acquisition by looking to changes in the target's functions, assets, and risks. Practitioners commonly refer to these cases as "FAR" cases to reflect the fact that the ITA relies on changes to the functions performed, assets owned, and risks assumed — rather than distinct intangible-property transfers — to infer a broader transfer of economic value.

Although the acquired Israeli companies often remain operational post-acquisition, as one would expect, they are integrated to varying degrees into the acquirers' businesses. Integration means things change. Those changes often include

[1] Joanna Glasner, "These Countries Have the Most Startup Investment for Their Size," Crunchbase News, Nov. 2, 2021.

[2] Sengul Enginsoy, "Top Unicorn Cities and Countries in 2025," StartupBlink (Sept. 4, 2025).

[3] Initial public offerings are less common as an Israel exit vehicle.

[4] Deborah Mary Sophia and Krystal Hu, "Alphabet to Buy Wiz for $32 Billion in its Biggest Deal to Boost Cloud Security," Reuters, Mar. 18, 2025.

[5] *Id.*; Sharon Wrobel, "Despite War, Tech Exits Soared to $59 Billion in 2025 Thanks to Wiz Deal — Report," *The Times of Israel*, Dec. 16, 2025.

reprioritization of development areas, products, and customers. They can also include a fundamental shift in the role of the Israeli company following the acquisition. In transfer-pricing parlance, an acquired company might move from an "entrepreneur" — bearing significant risk of loss and profit potential — to a "service provider" — earning a routine return (often for research and development services). From an economic standpoint, these transitions can stabilize formerly cash-burning startups, preserve employment, and generate stable and predictable taxable income in Israel where none previously existed. That is true even when the underlying acquired business, product line, or product ultimately fails to pan out.

The ITA has focused on what happens to Israeli companies after these acquisitions. Concerned that traditional transfer pricing tools might allow value to leave Israeli companies without appropriate compensation, the ITA has actively pursued assessments against Israeli targets. The Israeli entities are the ITA's formal assessment targets, but non-Israeli parent companies usually set the strategy and remain in the driver's seat on major case decisions.

The ITA often advances FAR-based positions early in audits and pursues them aggressively even when traditional transfer pricing analyses are available. The ITA's FAR adjustment typically takes the form of a deemed capital gain, with the alleged value transfer measured by reference to the third-party acquisition price. By treating post-acquisition restructuring as evidence that the Israeli entity's pre-acquisition enterprise value has migrated abroad, the ITA can justify referencing the acquisition price for the valuation. This can result in an adjustment that approaches the full acquisition price, even where the taxpayer has separately priced specific intercompany transactions.

Local assessing offices regularly assert FAR-based recharacterizations alongside more conventional pricing and valuation adjustments. In practice, the ITA's FAR approach often represents the most expansive adjustment available. That dynamic helps explain why the ITA might pursue a FAR-based approach even where traditional transfer-pricing tools could address the perceived misalignment.

The ITA's reliance on FAR-based recharacterization is not merely an effort to police discrete intangible-property transfers. It reflects a broader desire to protect the domestic tax base and raise revenue. That is understandable. The difficulty is that FAR-based attacks have put Israeli courts in the unenviable position of policing an ill-defined boundary between ordinary post-acquisition integration and amorphous claims of value migration on hindsight-driven records. When deployed against ordinary post-acquisition integration, or triggered by the subsequent failure of an acquired business or product, the ITA's FAR-based attacks risk supplanting a proper (and more predictable) transfer pricing analysis with an outcome-oriented endgame. In doing so, the ITA risks deterring foreign investment, negatively affecting the prices paid for Israeli companies, distorting deal integration, and undermining the long-term growth and stability that Israeli policymakers seek to encourage.

FAR-based recharacterization is a powerful tool. It might be warranted in exceptional cases in which a business restructuring results in the uncompensated relinquishment of economically meaningful rights that an independent enterprise would not have surrendered gratis. Because FAR-based recharacterization can override transactional form and produce large adjustments, it warrants restrained use and careful attention to analytical sequencing.[6] But the recent case law and anecdotal evidence suggest that the ITA regularly deploys FAR-based recharacterization as a shortcut rather than as a measure of last resort.

Multiple FAR cases have wound their way through Israeli district courts in recent years, with mixed results. One such case, involving Medtronic, resulted in a district court judgment applying an exitstyle FAR framework. That case is currently before the Israeli Supreme Court. While a supreme court decision could bring doctrinal clarity, cases of this kind seldom yield bright-line rules.

[6] Once the transactions constituting a business restructuring are accurately delineated, there may be circumstances in which referring to a third-party acquisition provides a sensible starting point for valuation. Identifying the specific rights transferred first clarifies what adjustments to that third-party benchmark are necessary to reflect the scope of the actual international transfer and to avoid attributing taxable value to assets that were not transferred.

In this article, we explain that Israeli FAR case law is best understood through this boundary-policing lens and argue that FAR-based analyses should be used only to assist in accurately delineating intercompany transactions and not as an analytical shortcut to replace the identification and pricing of those transactions. Misuse of FAR in place of a defensible transfer-pricing analysis creates a "heads I win, tails you lose" regime for acquirers of Israeli startups. When the acquired business succeeds, Israel taxes the upside through ordinary income streams. When it fails, the ITA uses hindsight-driven recharacterization to tax acquisition value ex post, including anticipated value that never materialized or that reflects acquirer-specific synergies rather than transferred assets. In continuing to rely excessively on FAR, the ITA risks impairing the broader economic objectives Israel seeks to achieve.

The Evolution of FAR-Based Adjustments in Israel

For nearly a decade, Israeli courts have been asked to reconcile conventional transfer-pricing adjustments — pricing identifiable controlled transactions under the arm's-length standard — with FAR-based recharacterization, which treats post-acquisition business changes as evidence of an earlier enterprise-level value transfer. The cases demonstrate that a court can reach a defensible outcome even when its analysis begins with a hindsight-based business narrative and works backward. A better analytical sequence in which the court first delineates what was actually transacted and then prices it would prevent an ex post commercial outcome from acting as proof of an earlier taxable transfer.

Gteko Ltd.

The first significant FAR case was *Gteko Ltd. v. Kfar Saba Assessing Officer*, decided in 2017 by Judge Shmuel Bornstein.[7] Gteko was an Israeli company established in 1992 that provided automated technical support solutions to electronic equipment manufacturers. Microsoft acquired all shares of Gteko for $90 million in 2006. Shortly thereafter, Gteko's employees were transferred to another Israeli company, Microsoft Israel, and continued to engage in R&D services for Microsoft in exchange for a cost-plus return.[8] In 2007 Gteko sold all of its intellectual property to Microsoft for $26.6 million (an amount reported on Gteko's Israeli tax return).[9] Relying on section 85A(a) of the Income Tax Ordinance, the ITA adjusted Gteko's income on the basis that the amount paid for the IP should have included Gteko's full value based on the stock acquisition.[10]

In a 2017 opinion, Bornstein concluded that the 2007 transaction between Gteko and Microsoft was far more extensive than the one described in the intercompany sale agreement.[11] He found that the value associated with synergies and Gteko's workforce was transferred to Microsoft.[12] A key premise of his reasoning was the before-and-after picture — Gteko warranted a $90 million purchase price and shortly thereafter was left with little remaining value. In Bornstein's words, the Israeli entity had become "an empty corporate shell."[13]

Bornstein's analysis of Gteko's workforce highlights the problems that arise when FAR-based reasoning supplants transaction identification. The ITA invited the court to compare Gteko pre- and post-acquisition and to infer a broad value transfer based on that comparison rather than to begin by identifying the specific asset transfers (whether or not they were reflected in an intercompany agreement).[14] Framed that way, it became possible to conflate assets that were transferred in an international transaction — the predicate for a section 85A adjustment — with changes resulting from a purely domestic transaction or from intervening business events that reduced Gteko's enterprise value.

[7] *Gteko Ltd. v. Kfar Saba Assessing Officer*, TA 49444-01-13 (June 6, 2017). In the original Hebrew version of the decision, the company's name appears in a form that would be transliterated as "Jitco." We use "Gteko" here, which is consistent with the spelling used by the court when quoting English-language transactional documents and with the company's English trade name.

[8] *Id.* at para. 5.

[9] *Gteko Ltd.*, *supra* note 7, at paras. 3 and 7.

[10] *Id.* at para. 39.

[11] *Id.* at para. 46.

[12] Bornstein reduced the ITA's proposed adjustment to exclude the portion of the share purchase price that was contingent on the continued employment of certain key employees.

[13] *Gteko Ltd.*, *supra* note 7, at para. 148.

[14] *Id.* at para. 26.

Within this framework, Bornstein reasoned that the know-how and experience embodied in Gteko's workforce was transferred to Microsoft once the employees began providing services for Microsoft on a cost-plus basis.[15] But those employees, who maintained their know-how and experience, moved to another Israeli company in a change that by itself would not have implicated section 85A, which applies only to international transactions. Bornstein summarily dismissed the purely domestic nature of the transaction on the basis that Microsoft was the common parent of both Israeli entities.[16] That observation establishes a special relationship (the term for a controlled transaction under Israeli law and a separate predicate for making a section 85A adjustment), but it does not convert a purely domestic transfer of employees into an international transaction within the meaning of section 85A.[17] Moreover, Microsoft Israel continued to perform R&D services in Israel in exchange for a cost-plus return, which means that at least some portion of the Gteko workforce's know-how and experience remained in Israel and continued to generate taxable income there on an ongoing basis.

If the intra-Israel workforce transfer was excluded from the scope of the international transaction in *Gteko*, a more traditional transfer pricing analysis could have focused on identifying and pricing the specific rights transferred in the 2007 intercompany transaction instead of expanding the scope of that transaction to include the broader enterprise value reflected in the 2006 share purchase. The appropriate inquiry would have been to compare Microsoft Israel's activities with those of the uncontrolled R&D service providers used to benchmark its cost-plus return. To the extent that Microsoft Israel possessed a higher level of unique know-how than the comparables (that is, if it had in-process R&D not already captured in the valuation of its transferred intangible property), the difference could have been addressed through an adjustment to the R&D service fee or to the price paid for the technology transfer without treating the workforce itself as a transferred asset.[18]

In discussing the value of the share transaction that Gteko attributed to expected synergies, Bornstein sensibly characterized synergies as a source of value that could affect the value of transferred assets (rather than treating them as a stand-alone asset).[19] That is consistent with orthodox valuation principles to the extent it recognizes that parties often anticipate that acquisitions will result in synergies and that sellers can capture a portion of that value in an arm's-length sale. But the analysis becomes problematic once synergistic value embedded in the share purchase price is treated as presumptively attributable to assets transferred in a subsequent controlled transaction, without a clear showing that those assets were in fact transferred out of Israel.

Once it is recognized that some portion of the Gteko workforce's know-how and experience remained in Israel after that workforce moved to Microsoft Israel, Bornstein's attribution of all acquisition-related synergies to internationally transferred assets becomes less justified. To the extent synergistic value arose from the combination of Microsoft's existing platform with the ongoing services performed for it in Israel, that value arguably belonged to Microsoft as the party that bore the ongoing risks by guaranteeing Microsoft Israel a profit. Treating such future, buyer-driven synergies as evidence of an uncompensated transfer risks conflating intercompany intangible-property transfers with the acquirer's own risk-taking and post-acquisition integration decisions.

In the end, Bornstein's analysis appears driven largely by his conclusion that Gteko had become an "empty shell." He reasoned backwards from that eventual enterprise-level outcome that all economically meaningful value must have been

[15] *Id.* at para. 89.

[16] *Id.* at para. 93.

[17] It is unclear the extent to which the taxpayer raised the purely domestic nature of the workforce transfer as a threshold issue under section 85A or whether highlighting that the workforce transfer occurred between two related Israeli corporations would have triggered a separate adverse tax effect. To the extent that argument was not fully developed, the court's analysis might have proceeded on the assumption that common ownership was sufficient to bring the workforce transfer within the FAR framework.

[18] Example 2 in Income Tax Circular No. 15/2018, which was released after *Gteko*, acknowledges that when an acquired company becomes an R&D service provider after integration, some portion of its intangible assets are used to generate its ongoing returns.

[19] *Gteko Ltd., supra* note 7, at para. 74.

previously transferred out of Israel. The outcome might well have been different had he identified the specific rights actually relinquished and priced those rights on arm's-length terms.

Perhaps the old adage that bad facts make bad law explains the result in *Gteko*. It is entirely reasonable to ask whether an independent company acting at arm's length would have agreed to a series of transactions that left its existing business without a workforce or any future business prospects in exchange for the consideration paid for IP that amounted to approximately 30 percent of its enterprise value. But that intuition should not replace the analytical steps required under a normal transfer pricing inquiry. The relevant question should not be whether the transaction appears value-destructive in hindsight but whether specific, economically identifiable rights were transferred in an international transaction and, if so, whether they were compensated on arm's-length terms. Treating the collapse of the residual business as proof that everything must have been transferred risks reducing that inquiry to an outcome-driven conclusion rather than a pricing analysis grounded in the identification of assets and rights.

Income Tax Circular No. 15/2018

The ITA issued Income Tax Circular No. 15/2018 following its win in *Gteko*. The 2018 circular sought to enshrine and extend aspects of *Gteko* while broadening the situations in which the ITA can assert FAR-based adjustments.

The 2018 circular continues to frame the inquiry primarily around changes to functions performed and risks assumed by Israeli companies before and after a restructuring.[20] While the 2018 circular cites the OECD transfer pricing guidelines' chapter on business restructurings, it does not consistently reflect the OECD guidelines' core sequencing principle — namely, that a FAR analysis is intended to assist in accurately delineating the relevant transactions, not to operate as an independent trigger for recharacterization.[21]

The 2018 circular's treatment of assembled workforce appears to amount to a partial retreat from *Gteko's* broad pronouncements. Rather than suggesting that a transfer of workforce occurs whenever a cost-plus arrangement is adopted, the 2018 circular states that such an arrangement could lead to a transfer of intangibles such as know-how.[22] In the second example at the end of the 2018 circular, the ITA concludes that an Israeli entity that becomes a cost-plus service provider should be paid for the intangible value associated with its workforce either as part of the price paid for transferring the intangibles or through the ongoing compensation received as part of the service arrangement. That clarification moves in the right direction by recognizing that workforce-related value, to the extent it is compensable at all, should be addressed through pricing rather than through a categorical inference of a wholesale workforce transfer.

The 2018 circular is at its weakest when it advocates for evaluating business restructurings by focusing on the before and after condition of the Israeli company instead of on the specific transactions that caused those changes.[23] A transactional focus would require the ITA to identify value transferred in transactions subject to section 85A rather than capturing an undifferentiated value reduction that might include assets that remained in Israel or value that was eroded by intervening business events. The 2018 circular makes a passing reference to intervening events,[24] but it treats such events as necessitating adjustments at the end of the analysis rather than as threshold questions that define the scope and nature of the transactions under consideration. That sequencing choice, which inverts the OECD guidelines' analytical framework, facilitates hindsight-driven reasoning by allowing outcome-based conclusions to precede transaction delineation and increases the likelihood that ordinary post-acquisition developments will be recast as evidence of a taxable value transfer. Later cases illustrate the consequences of that approach and highlight the

[20] Income Tax Circular No. 15/2018, at section 4.2.

[21] OECD transfer pricing guidelines (2017), at paras. 9.16-9.18.

[22] Income Tax Circular No. 15/2018, *supra* note 20, at section 3.

[23] *Id.* at section 6.1.

[24] *Id.* at section 6.3.7.

need for clearer sequencing and greater restraint in this realm.

Broadcom

The first case to test the theories espoused in the 2018 circular was another FAR-based case brought before Bornstein in the Lod Central District Court — *Broadcom Semiconductor Ltd. v. Kfar-Saba Assessing Officer*.[25] Unlike in *Gteko*, the transaction in *Broadcom* did not involve an assignment of IP.[26] Instead, the acquired Israeli entity entered into a license agreement for its existing IP (under which it received royalties) and service agreements covering marketing and development.[27] Consistent with its deemed-sale theory outlined in the 2018 circular,[28] the ITA argued that the aggregate effect of the intercompany agreements following the share acquisition constituted a FAR transfer that should be valued based on the share purchase price paid by Broadcom.[29]

Bornstein rejected the ITA's position, determining that no transaction occurred that was broader than the license and service transactions reflected in the intercompany agreements.[30] He observed that a business restructuring alone does not give rise to a finding that a FAR-based adjustment is appropriate, even where a company reduces its long-term risks and profit potential in exchange for royalties and cost-plus returns.[31] Critically, Bornstein found that the taxpayer was able to divide between existing know-how (which the Israeli entity continued to own and license for royalties) and the fruits of new development (which would be owned by the services recipient).[32] Even though existing know-how was licensed and used in new development, he recognized that the appropriate analysis was to examine the pricing question under ordinary transfer pricing principles rather than to treat the restructuring as a broader value transfer.

Although the result in *Broadcom* is sound, aspects of the court's reasoning are problematic. In particular, the opinion places significant weight on whether the size of the Israeli workforce declined following the post-acquisition restructuring.[33] The size of an Israeli workforce can change for a range of reasons that have little or no bearing on whether assets were transferred outside of Israel in a controlled transaction. For instance, an acquirer might decide to consolidate certain functions where the acquirer already maintains a local presence. Development priorities might also shift for commercial reasons that have nothing to do with whether a controlled transaction occurred. Treating workforce preservation or growth as indicators of value retention in Israel risks elevating an outcome-based proxy into a decisive factor in an analysis that should focus on the identification and pricing of specific transferred assets. More importantly, reliance on workforce size as a proxy creates perverse incentives by encouraging acquirers to make post-acquisition staffing and integration decisions with an eye toward avoiding adverse Israeli tax consequences rather than toward economic efficiency.[34]

Medingo

In 2022 a case similar to *Broadcom* was brought before Judge Yardena Seroussi in the Tel Aviv-Jaffa District Court — *Medingo Ltd. v. Afula Assessing Officer*.[35] Medingo was an Israeli

[25] *Broadcom Semiconductor Ltd. v. Officer Kfar Saba*, 24362-10-04 (Dec. 9, 2019).

[26] Although the restructuring in *Broadcom* did not involve an assignment of IP at the time, the Israeli entity later sold its preexisting IP to a foreign affiliate for substantial consideration following a subsequent unrelated acquisition. *Broadcom Semiconductor Ltd.*, *supra* note 25, at para. 71. Bornstein noted that the later sale price was meaningful in relation to the earlier share purchase price and treated that transaction as confirmation that the legacy IP retained independent value and had not been implicitly transferred as part of the initial licensing and services arrangements.

[27] *Broadcom Semiconductor Ltd.*, *supra* note 25, at paras. 9-12.

[28] Income Tax Circular No. 15/2018, supra note 20, at section 5.2.

[29] *Id.* at para. 33.

[30] *Id.* at para. 41.

[31] *Id.* at para. 36.

[32] *Id.* at para. 69.

[33] *Id.* at para. 61.

[34] There may be exceptional circumstances in which a wholesale transfer of workforce is difficult, if not impossible, to reconcile with arm's-length behavior — particularly if the workforce embodied the company's core know-how and nothing was paid by the transferee. Setting aside the purely domestic nature of the workforce transfer, *Gteko* may illustrate such an edge case. But even in those extreme circumstances, the bar for FAR-based recharacterization should remain high. The analysis should identify the specific assets allegedly transferred and examine whether they were compensated on arm's-length terms rather than simply inferring a wholesale transfer from the subsequent collapse of the business.

[35] *Medingo Ltd. v. Afula Assessing Officer*, TA 53528-01-16 (May 8, 2022).

company that developed a unique wireless insulin pump before it was acquired by Roche Group. As in *Broadcom*, the acquired Israeli entity in *Medingo* and the foreign acquirer entered into a license agreement for the Israeli entity's existing IP (for which it received royalties) and a separate service arrangement through which it would develop new IP in exchange for cost-plus compensation.[36]

Seroussi disagreed with the ITA and concluded that there was no loss of economic value that would not be captured simply by adjusting the transfer prices for the transactions reflected in the intercompany agreements (the license and service arrangement).[37] She expressly rejected the ITA's position that an intangible transfer can be inferred from the Israeli company's change from an entrepreneur to an entity that follows the strategy set by a foreign company.[38] She noted that Medingo followed the strategy set by its shareholder both before and after the acquisition and that the only change was the identity of the shareholder. Seroussi further rejected the ITA's contention that Medingo's change in risk profile constituted an asset sale.[39]

Seroussi's analysis recognizes the economic tradeoff inherent in de-risking an entrepreneurial entity. When a precommercial startup burning cash shifts to a cost-plus model, the change in risk profile can immediately turn a company earning no taxable income into one earning stable, guaranteed returns. That transition benefits Israel even if the underlying business ultimately fails.

By anchoring her analysis in the intercompany transactions and related pricing mechanisms — rather than a before-and-after assessment of the Israeli entity — Seroussi emphasized that changes in governance, risk allocation, and business model are not themselves indicative of a compensable transfer and demonstrated that traditional transfer-pricing analyses offer a reliable way to address business restructuring transactions.[40] At the same time, Seroussi assigned weight to the fact that the Israeli workforce expanded after the acquisition. Reliance on post-restructuring outcomes introduces the same problematic proxy-based reasoning as in *Broadcom*. Accordingly, although *Medingo* more clearly limits the use of outcome-based indicators than *Broadcom*, it does not entirely disentangle FAR analysis from post-restructuring facts, leaving real ambiguity as to the role such considerations might play in future cases.

Medtronic

Bornstein's 2023 opinion in *Medtronic* is perhaps the most troubling of those in the FAR cases.[41] Like *Broadcom* and *Medingo*, *Medtronic* involved an acquired Israeli entity — Medtronic Ventor Technologies — that entered into a royalty-bearing license for its existing IP and a cost-plus R&D services arrangement for new IP.[42] Despite the similarities to those cases, Bornstein decided that a FAR adjustment was appropriate because, after the acquisition, all of the Israeli entity's activities were directed toward serving the interests of its new foreign parent.[43]

The most serious concern arising from Bornstein's opinion is the seemingly dispositive weight he assigned to the post-acquisition diminution of Medtronic Ventor Technologies' managerial autonomy and strategic discretion.[44] But those changes are ordinary and expected consequences of integration after a cross-border

[36] *Id.* at para. 3.

[37] *Id.* at para. 62.

[38] *Id.* at para. 66.

[39] *Id.* at para. 81.

[40] Another 2022 decision highlights the importance of using traditional transfer-pricing tools. In *CA Software Israel Ltd. v. Tel Aviv 3 Tax Assessing Officer*, 61226-06-17 (Oct. 25, 2022), the dispute concerned the sale of IP outside of Israel and the Israeli company's transition to a cost-plus service-provider role. Although the parties used income-based methods, they applied them to value the transferred IP rather than the Israeli enterprise. As a result, the issues that permeate FAR-based disputes played no role in the court's analysis.

[41] *Medtronic Ventor Technologies Ltd. v. Kfar Saba Assessing Officer*, TA 31671-09-18 (June 2, 2023).

[42] *Id.* at para. 5.

[43] *Id.* at para. 45.

[44] *Id.* at paras. 58-64 and 92-98.

acquisition: Strategic oversight resides at the parent level, and reporting lines change as the newly integrated employees report into the acquirer. Absent a showing that the Israeli entity relinquished preexisting rights to exploit assets, the mere fact that decision-making migrated to the new foreign parent level risks collapsing standard post-acquisition integration into a proxy for a taxable FAR transfer.

To be sure, under current OECD transfer-pricing principles, profits are expected to follow development, enhancement, maintenance, protection, and exploitation (DEMPE) functions. When DEMPE functions move together with ownership or control of intangible assets, profit expectations shift accordingly. But, in isolation, the relocation or loss of DEMPE functions does not constitute a compensable transfer of intangible property. Absent the movement of the underlying assets or rights to exploit them, changes in DEMPE are addressed within the OECD framework through transaction delineation and arm's-length pricing of the transaction — not through exit-style recharacterization of the business restructuring as the sale of a business enterprise.

Bornstein's analysis here is difficult to reconcile with Seroussi's *Medingo* opinion in which she observed that companies are generally directed by their shareholders both before and after an acquisition. Medtronic was able to control the operations of Medtronic Ventor Technologies because it acquired all the shares of that company, not because any Israeli assets were separately transferred to Medtronic.

This problem was compounded by Bornstein's reliance on hindsight. Medtronic Ventor Technologies continued to operate after the acquisition and to provide services on a cost-plus basis to its new foreign parent before it was ultimately shuttered without any further sale, license, or compensation.[45] Bornstein could have treated the absence of ongoing royalties as evidence that value remained in Israel but was simply undercompensated. Instead, he treated the subsequent shutdown of the Israeli entity as proof that no monetizable value remained there at all. On that basis, he inferred that the value reflected in the acquisition price must already have been absorbed elsewhere within the group.[46]

That inference necessarily relies on subsequent commercial outcomes to establish previous value shifts, equating post-acquisition business evolution with evidence of a prior compensable transfer warranting FAR-style recharacterization. In doing so, the analysis substitutes judicial hindsight for the acquirer's ex ante business judgment. Medtronic's ultimate decision to discontinue the Israeli operation reflected its assessment of commercial risk and opportunity — an assessment it was entitled, and uniquely positioned, to make as shareholder. The authority to make that decision flowed from

[45]It is doubtful whether the cessation of Medtronic Ventor Technologies' operations is properly characterized as a "business restructuring" within the meaning of Chapter IX of the OECD guidelines — the ITA's stated basis for its FAR-based recharacterizations. Chapter IX focuses on changes in the commercial or financial relations between affiliates, not on shareholder decisions to discontinue operations in the absence of a corresponding change in intercompany transactions. See OECD guidelines (2022), at para. 9.1 (defining a "business restructuring" as "the cross-border reorganisation of the commercial or financial relations between associated enterprises"), para. 9.2 (illustrating a restructuring through changes in the transactions engaged in by related parties), and para. 9.11 (framing the inquiry as whether "conditions have been made or imposed in transactions comprising a business restructuring that differ from those that would be made or imposed between independent enterprises"). Absent a showing that identifiable assets were transferred from Medtronic Ventor Technologies to Medtronic as part of the winding down of the Israeli operations, the record does not clearly establish a wind-down-related transaction occurred that would fall within Chapter IX.

[46]Under domestic Israeli law, ceasing or derogating business activity for the benefit of another can constitute a capital event under certain circumstances. But Bornstein did not clearly distinguish between a domestic-capital-event analysis and his FAR-based reasoning. By moving quickly from the fact of shutdown to his conclusion that enterprise-level value had previously migrated, his analysis blurs the line between domestic capital-event characterization and the pricing analysis required under transfer pricing principles.

ownership of the shares, not from any separately identified transfer of economically compensable rights from the Israeli entity to the parent.[47]

As additional evidence of a transfer of the Israeli business, Bornstein pointed to the fact that a small number of Medtronic Ventor Technologies' patents were registered in Medtronic's name after the acquisition.[48] But the record reflected that Medtronic Ventor Technologies remained functionally and financially responsible for developing the underlying inventions, that no assignment agreement or consideration existed, and that Medtronic continued to pay royalties to Medtronic Ventor Technologies as the owner of the relevant patent portfolio. Under those circumstances, registration anomalies provided a weak basis for inferring a transfer of economically meaningful rights. More fundamentally, standing alone, reliance on shareholder control (in this instance, control over patent registration) adds little to a transfer pricing analysis, which turns on whether compensable rights were transferred and mispriced or whether an independent enterprise would have agreed to the restructuring without compensation, not on the undisputed fact that a parent directs the affairs of its wholly owned subsidiary. Viewed that way, the misregistration could have been disregarded as inconsistent with economic substance without treating it as evidence of a broader enterprise-level transfer.

Having concluded that recharacterization was warranted, Bornstein moved quickly from observing that cost-plus remuneration exhausted Medtronic Ventor Technologies' post-acquisition income stream to concluding that traditional transfer pricing must therefore have failed. That conclusion did not rest on a showing that established pricing methods were unavailable or an analysis of whether alternative pricing structures, such as adjustments to the service fees or royalties, could have addressed the perceived misalignment. In effect, FAR-based recharacterization functioned as a substitute for a pricing analysis rather than as a measure of last resort.

Inconsistency and the Need for Clarity

Taken together, *Broadcom*, *Medingo*, and *Medtronic* illustrate the difficulty created by the ITA's aggressive reliance on FAR-based recharacterization. In *Broadcom* and *Medingo*, courts confronted similar post-acquisition structures — royalty-bearing licenses coupled with cost-plus service arrangements — and refused to infer a taxable transfer of enterprise value where pricing tools were available to address any perceived misalignment. In *Medtronic*, materially similar arrangements produced the opposite result. Notably, the same judge who rejected recharacterization in *Broadcom* later sustained it in *Medtronic*, allowing post-acquisition integration, subsequent business decisions, and an eventual shutdown to drive his analysis.

That divergence underscores the extent to which FAR disputes have become exercises in case-by-case boundary policing, with outcomes turning less on clearly articulated doctrinal rules than on judicial assessments of post-restructuring facts. The resulting inconsistency and uncertainty reflect the strain placed on courts when the ITA deploys FAR analysis as a primary enforcement tool rather than as a subsidiary aid to transaction identification and pricing. This dynamic is compounded by the fact that Israeli district court decisions are not binding precedent and do not formally constrain the ITA, leaving the FAR doctrine to develop incrementally and, in practice, in an ad hoc manner.

The Mutual Agreement Procedure Channel

Beyond doctrinal clarification, existing dispute-resolution mechanisms under treaties can also play a useful role in moderating the effects of aggressive FAR assertions. One apparent feature of the FAR cases that have proceeded to litigation is the limited use of the mutual agreement procedure under applicable tax treaties. The U.S.-Israel MAP channel is generally regarded as well functioning, and the Israeli competent authority has demonstrated a willingness to narrow or withdraw

[47] Competition-law sensitivities likely explain the absence of these transactions in arm's-length markets. Whatever the reason, the lack of a clear arm's-length analog in this context reflects the difficulty of identifying arm's-length circumstances in which an enterprise would agree to be paid simply to cease operations without a corresponding transfer of its assets or rights. That difficulty highlights the need for careful identification of what, if anything, was actually relinquished in the restructuring, rather than inferring compensation obligations from shareholder control alone.

[48] *Medtronic Ventor Technologies Ltd.*, *supra* note 41, at para. 72.

aggressive examination positions when presented with well-developed treaty-based arguments.

Several high-profile FAR disputes nevertheless appear to have advanced directly to litigation without meaningful MAP engagement. The reasons for bypassing MAP likely vary. In some cases, taxpayers may have concluded that the asserted FAR positions were unlikely to be moderated through administrative processes. In others, litigation may have been pursued for strategic or timing reasons unrelated to the prospects of a potential MAP resolution. Whatever the explanation, forgoing a potentially valuable bite at the apple is a missed opportunity. For taxpayers facing FAR-based challenges, early and serious MAP consideration is a vital part of any comprehensive dispute-resolution strategy.

Conclusion

Based on the case law and anecdotal evidence, the ITA has increasingly asserted FAR-based recharacterization as an expansive alternative adjustment rather than as a measure of last resort. FAR claims are often asserted alongside more conventional pricing theories and, where sustained, can produce the largest adjustments. Standing alone, changes such as ordinary post-acquisition integration (for example, centralized reporting lines, budgeting, and business roadmaps/strategy), subsequent business failures, and the conversion of the acquired company from an entrepreneur to a cost-plus service provider cannot justify an analytical shortcut to taxing acquisition value.[49]

Labeling the Israeli target as an empty shell or using some other pejorative moniker merely describes post-integration outcomes, but it does not identify the specific property actually transferred or explain why an uncontrolled transferee would have paid for it. Absent a specific showing of an uncompensated relinquishment of economically valuable rights, which traditional transfer pricing tools and the OECD's more recent business-restructuring framework are well suited to address, such characterizations risk becoming proxies for taxing normal integration, business failure, or other developments that do not constitute the transfers of compensable intangible assets.

Left unchecked, FAR-based recharacterization creates a "heads I win, tails you lose" asymmetry: An acquired Israeli startup is either a success (in which case the ITA will be able to tax its income) or it is a failure (in which case the ITA will allege that value migrated out of Israel and must be taxed). That outcome is difficult to reconcile with arm's-length behavior.

The real question is when, if ever, FAR-based recharacterization is necessary if the ITA is applying transfer pricing principles in a disciplined and careful manner. If value is transferred, then the analytical starting point should always be identifying the intangible property allegedly transferred without adequate compensation. The next step should be to prove that the intangible property was in fact transferred and that the transfer was not priced in a manner arm's-length parties would have adopted.

Divergence between form and substance may justify recharacterization to align the tax analysis with the parties' actual conduct. But the ITA does not need FAR-based recharacterization as a distinct analytical construct for that purpose. At their core, transfer pricing principles elevate substance over form and are well equipped to address mismatches between the written form of a transaction and what actually occurred.[50] The same tools are adequate for addressing situations in which intercompany agreements are silent or nonexistent and the ITA believes the Israeli target silently relinquished value for which an arm's-length recipient would have paid.

Amorphous value-transfer concepts are likewise an insufficient justification for resorting to FAR-based recharacterization. A target's exit from a product or business line is not an intangible-property transfer to the acquirer unless the target in fact transferred the value associated with that business, in which case the transferred IP bundle can be priced as such through a

[49] The ITA has also reportedly pointed to Israel Innovation Authority grant-repayments arising after post-acquisition integration as evidence of IP transfers out of Israel. The existence of a regulatory repayment under a different regime does not, by itself, establish that a compensable international transfer of IP occurred for section 85A purposes.

[50] OECD guidelines (2022), at para. 1.46.

traditional transfer pricing analysis grounded in arm's-length principles.

Income Tax Circular No. 8/2025 establishes internal escalation mechanisms within the ITA for FAR-related positions and offers taxpayers a very expensive path to certainty where they elect to formally transfer intangible assets after an acquisition. Rather than revisiting the substantive contours of FAR-based recharacterization, the 2025 circular establishes a pricing framework under which taxpayers can elect to value the transferred intangibles using a substantial percentage (85 percent) of the third-party acquisition price.[51] Although this mechanism may function as a safe harbor for taxpayers seeking certainty, it does not resolve the underlying doctrinal question of when FAR-based recharacterization is appropriate in the absence of a formal transfer. While the 2025 circular might improve administrability in certain individual cases, it in no way addresses — let alone resolves — the fundamental question of when FAR-based recharacterization is appropriate in the first place.[52]

As things stand, the ITA's approach puts Israeli courts in the difficult position of policing an undefined boundary between ordinary post-acquisition integration and amorphous claims of value migration — often on hindsight-driven records. The resulting uncertainty discourages foreign investment and could distort post-acquisition behavior. There are indications that policymakers recognize these costs and the tension they create with Israel's long-term interest in attracting capital and fostering predictable, stable economic growth. Clarifying the proper role of FAR-based recharacterization requires less case-by-case adjudication and clearer guidance on how arm's-length principles apply in this setting.

The emerging case law nevertheless points to a workable way of thinking about these disputes. FAR-based recharacterization makes sense only as an exceptional tool to be used when traditional transfer pricing methods genuinely cannot identify and price the transactions at issue. Much of the inconsistency in the cases stems from skipping that sequencing and allowing post-acquisition outcomes to drive the analysis. Requiring the ITA to delineate the relevant transactions and exhaust conventional pricing tools first would go a long way toward restoring coherence. Where doctrinal uncertainty persists, MAP may offer a more predictable alternative to litigating these issues case by case. Without clearer analytical boundaries, however, uncertainty is likely to continue shaping investment decisions and post-acquisition behavior well beyond the cases now before the Israeli courts. ■

[51] The percentage is adjusted by addbacks, including for employee-related payments and certain grant repayments, that can bring the valuation closer to the full enterprise value.

[52] On the positive side, the 2025 circular confirms that qualifying IP sales by special preferred technological enterprises (SPTEs) are eligible for the reduced 6 percent capital gains rate established under the innovation law amendments. This confirmation is among the most significant takeaways from the 2025 circular. It provides substantial rate relief for taxpayers that meet the SPTE thresholds and may reduce the stakes in FAR-based recharacterization disputes, even if it does not resolve the underlying doctrinal question of when FAR-based recharacterization is appropriate. That said, Israel's adoption of a qualified domestic minimum top-up tax effective for fiscal years beginning on or after January 1, 2026, could effectively reduce the benefit of the special SPTE rate going forward.