

# Tax

**GORNITZKY & Co.**

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# Israeli Tax Trends

In recent years, international competition for investments has substantially increased, inter alia, in light of the global crisis and worldwide slowdown. As a result, Israeli policy makers realized the implementation of new tax incentive policies was required to promote and develop competitive advantages and attract investments into Israel. Israel – the "Start-up Nation" – chose to encourage investments and operations in the field of technology. Accordingly, two significant changes were made:

## Tax-Free Reorganizations

The Israeli Tax Ordinance (ITO) sets terms and conditions for tax-free reorganizations, provided the economic identity of the shareholders is mostly preserved and no realization has occurred during a period of two years (Restriction Period). The limitations that were in force for almost two decades made it difficult for companies, especially in the high-tech sector, to expand their business and raise capital. Effective August 6, 2017, a major amendment of the ITO was made to increase the availability of tax-free restructurings by minimizing the aforesaid conditions and limitations.

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The main changes include: (i) the original shareholders may sell or dilute their shares providing they remain the holders of at least 25% of the merged company during the Restriction Period (rather than 51%); (ii) up to 40% of the consideration received in a tax-free reorganization may be in cash (rather than only in the form of shares); (iii) in a share-for-share merger, the receiving company will be required to hold only 51% (rather than 100%) in the transferred company during the Restriction Period; (iv) relief in the requirement to apply for a pre-ruling application in certain cases.

## Encouragement of Capital Investments Law

The Encouragement of Capital Investments Law is intended to encourage capital investments and economic initiatives of enterprises that meet certain requirements, mainly by providing reduced corporate tax rates.

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property in the country, effective as of January 1, 2017, a new incentive regime was implemented.

The new incentive regime (New Regime) provides tax benefits for two types of enterprises: (a) "Preferred Technology Enterprises" (PTE) and (b) "Special Preferred Technological Enterprises" (SPTE). The New Regime includes, inter alia, the following: (i) a reduced corporate tax rate of 12% on income that qualifies as "Preferred Technology Income" for PTE or 7.5% if the PTE is located in Development Region "A," and a 6% corporate tax rate for SPTE, regardless its geographic location; (ii) PTE and SPTE, subject to certain conditions, will benefit from a reduced corporate tax rate of 12% and 6% respectively on capital gains derived from the sale of certain "Benefitted Intangible Assets" to a related foreign company, and (iii) dividends distributed by a PTE or SPTE, paid out of Preferred Technology Income, will be subject to withholding tax of 20% or 4% if distributed to a foreign parent company that holds 90% or more of the shares of the PTE or SPTE.

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As noted, the Israeli tax legislator is trying to promote legislation that will encourage foreign investment and the development of economic activity in Israel, especially in the field of technology. At the same time, the policy makers and the enforcement authorities are aggressively closing various loopholes in the law and applying a strict enforcement policy. These include the following:

## Enhanced Scrutiny on Cross-Border Related Parties' Transactions

### (1) Change of Business Model

Israeli start-ups and technology companies have attracted many foreign investors over the years. Following an acquisition of an Israeli start-up, multinationals usually restructure the business model of the acquired company by selling or licensing its intangible assets to a related party abroad, and the Israeli company becomes an R&D center.

In recent years, these transactions have been scrutinized by the ITA, with our firm representing some of the companies involved. When the transaction is a license agreement – the ITA examines whether it is actually a sale of assets. When the transaction is a sale of the company's IP – the ITA examines whether the sale was done at fair market value.

In 2017, two major cases – the "Gteko" and "Mercury" – cases reached the Israeli headlines. In both cases, the ITA's claim that the IP was sold for a price significantly under the fair market value prevailed.

The aforesaid might significantly affect the structure and pricing of mergers and acquisition transactions of technology companies.

### (2) Preventing Deferral of Taxation by Shareholders in Closely Held Companies

To prevent the creation of a tax advantage for individual shareholders holding 10%



or more of the shares (Substantial Shareholder) in closely held companies, several amendments of the ITO came into force as of January 1, 2017, including (i) the withdrawal of funds from a company by a Substantial Shareholder by way of a loan, provision of a guarantee for a loan or provision of an asset for the use and benefit of the Substantial Shareholder that shall be deemed, upon the existence of certain conditions, as a distribution of dividend or business income if there are no sufficient profits for distribution; (ii) the ITA is authorized under certain conditions to view a closely held company as if 50% of its profits for the year have been distributed as a dividend; (iii) in a company in which income is derived from services provided by its Substantial Shareholder, the profits of the company might be directly attributed to that individual and thus subject to marginal tax rates (of up to 50%).

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Broad interpretation and application of the legislation might have broad tax implications on the operation of foreign corporations in Israel, including implications on M&A transactions and their financing.

### Exchange of Information & Increased Reporting

#### (1) Exchange of Information

To act upon OECD recommendations, Israeli policymakers have lately made a great effort to align with other countries with respect to exchange of information, including: (i) provision of authority to ITA to exchange information with foreign tax authorities, on its own initiative or pursuant to the request of a foreign country; (ii) changes enabling the ITA to comply with FATCA and CRS according to which the ITA shall be authorized to collect information held by Israeli banks and other Israeli financial institutions; (iii) adopting the recommendation of the BEPS – Action 13 with respect to "Transfer Pricing Documentation and Country-by-Country Reporting" into Israeli domestic tax law.

#### (2) Increased Reporting

The law imposes various reporting obligations in connection with tax planning and reliance on legal opinions by taxpayers. The ITA has published a series of tax positions that the taxpayer must report in his or her annual tax report.

In light of the above, it appears the legislation amendments may, in fact, make Israel more appealing. At the same time, increased transparency and full disclosure will result.



# Gornitzky & Co.

**Daniel Paserman, Partner, Head of Tax**  
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Gornitzky & Co. is one of Israel's most established commercial law firms, with a rich history spanning nearly 80 years. It is consistently recognized by international legal guides as a top-tier law firm across many practice areas. Over the years, Gornitzky & Co. has been involved in many of the largest, most complex and high-profile transactions to take place in Israel and has played a key role in the development of Israel's economic and commercial legal practice.

Gornitzky provides a full range of legal services including M&A, private equity and venture investments, technology, high-tech, taxation, banking and finance, infrastructure and project finance, energy, international and domestic capital markets, dispute resolution, restructuring and insolvency, real estate, regulatory matters and representation before government bodies. The firm has a global and local client base that includes Israel's largest businesses and corporate groups alongside foreign and multinational corporations and financial institutions.

For years, Gornitzky's Tax practice has been at the forefront of the Israeli tax arena and has been involved in many of the most complex tax cases in the country. The tax team advises on the most demanding, high-profile and high-value tax matters in the country, including domestic and global corporate tax, reorganizations and cross-border structuring, capital markets and financial products, taxation of high net worth individuals and trusts, transfer pricing, indirect tax, real estate tax and tax controversy and tax litigation, including white collar offenses. Many of these matters have set important precedents and have influenced Israeli tax laws in the making. In addition, the team is particularly well-known for its creative thinking and innovative domestic and international tax planning, including, in particular in multi-jurisdictional matters.

**Daniel Paserman** (CPA) heads Gornitzky's Tax practice. Daniel is involved in intricate corporate tax planning – both domestic and cross-border. His broad experience includes negotiations with the Israel Tax Authority (ITA) regarding tax regulatory issues, seeking and obtaining tax rulings for both Israeli and global companies operating in Israel, as well as handling wide-scope tax assessment cases and tax litigation for both global and Israeli corporations and private entities operating in Israel.

Daniel also advises private clients in matters concerning taxation of trusts and estates and provides tax planning guidance for high net worth individuals. He serves as the secretary of Society of Trust and Estate Practitioners Israel (STEP). He is also a lecturer on Corporate & International Taxation at Tel Aviv University.

**Danielle Skald** is an associate at Gornitzky. She advises clients on a range of taxation matters, extending from corporate tax and international taxation to domestic and cross-border restructurings, executive compensation and VAT.

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