GORNITZKY&CO

Israel Overview

by Dubi Gross, Partner, Gornitzky & Co.

Despite the continued volatility of the global financial markets, Israel's economy has remained relatively stable over the past few years. The Bank of Israel staff forecast indicates that GDP will continue growing, albeit not at the levels of recent years, and predicts that increases in the Israeli Consumer Price Index will be in the minimal to modest range. Israel's public debt to GDP ratio continued to decrease, unlike other OECD countries. This does not mean that there are no areas of concern. At this point, interest rates are expected to remain low, continuing to fuel a highly priced real estate market. The Israeli shekel has maintained a strong international position, raising concerns and slightly pessimistic forecasts regarding Israel's exporting power. In addition, after a somewhat prolonged and controversial search process, Dr. Karnit Flug was appointed as the governor of the Bank of Israel, which should re-instill confidence with market players.

A notable phenomenon is the increasing number of current and expected debt restructurings. In large part, this trend is the result of the existence of significant amounts of debt which need refinancing in the face of unfavourable market conditions, including decreases in the value of assets being financed, reduced debt-to-equity ratios at which banks are willing to lend, as well as the shrinking profitability of businesses. Because the Israeli debt restructuring market is relatively young in comparison with its European counterparts, it does not operate through a strict, tried and tested methodology. Debt restructurings in Israel tend to be contentious and receive relatively extensive media coverage with public sentiment playing a role. In fact, with the enactment of Amendment 18 to Israel's Companies Law, the Israeli parliament responded to popular concerns that institutional lenders were giving free passes to large corporate bond issuers. Under this amendment, a company looking to renegotiate the terms of its debt must request that the court appoint an expert to examine the fairness of any proposed arrangement.

In January 2013, Amendment 19 of the Companies Law took effect, introducing a new chapter relating to schemes of arrangement and corporate rehabilitation. Viewed by many as overreaching, the amendment allows the court to sanction a period of time for corporate rehabilitation, initially up to nine months with possible extensions. During this period, subject to court approval, all collection proceedings are stayed and cannot be commenced against the company. Furthermore, a court-appointed administrator is entitled to take various actions involving the company's assets, such as the sale or lease of assets, including those charged in favour of secured creditors subject to certain conditions set out in the Companies Law and, in certain cases, court approval. In addition, if the court is of the opinion that, under the then prevailing circumstances, the debtor cannot raise sufficient funds, it may permit the administrator to incur new indebtedness for the debtor having the benefit of a lower, equal or higher ranking security interest on assets that are already charged to an existing (secured) creditor, provided that the existing secured creditor is given "adequate protection". What constitutes "adequate protection" remains to be seen.

Israel continues to be driven by a robust and globally significant hi-tech industry. Unfortunately, the Tel-Aviv Stock Exchange ("TASE") has not been very active or liquid. Nevertheless, Israeli hi-tech companies have cashed in on a number of IPOs on foreign stock exchanges. In this vein, 2013 has been defined by the continuation of robust M&A activity, with a number of sizeable exits.

Israel's economy also stands to reap the benefits of large amounts of offshore natural gas discoveries in the area. The government commissioned the Tzemach Committee to determine the level of gas exports that it should permit, and in 2013 it approved the allocation of 40% of Israel's natural gas reserves for export, in an attempt to strike a balance between domestic energy needs and the economic feasibility of natural gas development. On the basis of the committee's recommendations, the government concluded that the administration of Israel's natural gas reserves will be under ministerial direction and not through parliamentary procedures. This decision was challenged by members of the Israeli parliament and various interest groups in Israel's High Court of Justice, which rejected the objections to the government's actions. In addition, although the field of energy exploration is mired in a complicated interplay of regulatory agencies, a recent report by the State Comptroller's Office may buoy the possibility of new discoveries. The office recommended that the regulatory process be streamlined into one agency or that the relevant bodies enter new levels of co-ordination in order to avoid the serpentine windings of complicated bureaucracies.

Finally, in order to correct a significant budget deficit, 2013 saw the government institute a number of significant changes to the Israeli tax code. As of January 1, 2014, personal income tax in Israel will increase amongst all income brackets, with the top bracket reaching 50% of one's income, and the corporate tax rate increasing from 25% to 26.5%. In addition, value-added tax was raised and set at 18%. The capital gains tax exemption for foreign shareholders has been removed if the assets of the company in which the shares were sold primarily represent "real property rights" in Israel, including rights to natural resources. Also, the criteria for foreign trusts to qualify for tax exemption has been narrowed, and excludes a trust with an Israeli beneficiary other than an Israeli charitable institution. In an attempt to cool the highly priced real estate market, there have been a number of changes in the area of land taxes, including limitations on exemptions relating to residential property, and increases in land purchase tax.