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Israel's tax authority is giving companies a quicker path to restructuring Israeli subsidiaries of foreign parent entities, by exempting the event from being taxable.

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# Israel Offers Fast Route to Restructuring in Nod to Startups

By Matthew Kalman

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- *U.S. investors vital to Israeli tech boom still prefer U.S. vehicles*
- *Practitioners divided on whether restriction-laden procedure will prove popular*

Israeli practitioners are divided on whether new tax regulations will counter the dampening effect of U.S. tax reforms on American investment in Israeli high-tech startups.

The Tax Authority rules, announced Oct. 2, provide a simpler “Green Route” for companies to restructure as the Israeli subsidiary of a foreign parent without triggering a tax event—easing businesses’ development and capital-raising. They can submit a detailed nine-page signed declaration rather than wait several months for an individualized Tax Authority ruling.

The new procedure, like the private rulings whose language was incorporated into the declaration and explanatory documents, is only available if the company fulfills a long list of conditions and if the intellectual property remains in the Israeli subsidiary.

The Tax Authority introduced the amendments in response to “changes in tax policies for attracting and preserving investments and capital, such as the Trump tax reform, which can result in investors' preference for taxation and regulation in their country of residence," according to an Oct. 2 news release.

Israel has struggled to respond to the 2017 U.S. tax reforms which discourage U.S. companies and individuals from investing abroad. The tax law imposes a new requirement that U.S. shareholders owning 10 percent or more of the stock of a controlled foreign corporation pay tax on what is called global intangible low-taxed income—income in excess of 10 percent of tangible depreciable assets. If it isn't already taxed at a certain rate elsewhere, the income will face a minimum tax imposed by the U.S.

U.S. investment has been a driving force behind the rapid growth of Israel's technology sector, which attracted $3.2 billion in the first half of 2018 and contributes nearly half of the country's total exports, but officials are concerned American funds could dry up under the new U.S. tax regime.

The new rules are "good for the Israeli high tech industry," said Harel Perlmutter, head of tax at Barnea law firm in Tel Aviv. "We've been waiting a long time for this Green Route. Especially now after the Trump reform with the GILTI tax, we see a lot of U.S. investors who tell us they cannot invest in Israeli companies. It was a dealbreaker in some deals I was involved with."

For U.S. investors, knowing "Israeli entities will quickly and easily be able to do to a flip and have their new parent entity in the U.S." will provide comfort, Perlmutter told Bloomberg Tax Oct. 4. He noted that "at the same time it won't be a big headache for the high-tech or startup company here in Israel."

## 'Complete Companies'

At the same time, Israel also wants to encourage its young startups to grow into "complete" businesses, keeping their intellectual property, production, management and marketing in the country so the economy can benefit from royalties, sales and job creation.

"The new track will give another boost to the establishment of Israeli companies in general and complete companies with IP in Israel in particular, while providing certainty, business flexibility and significantly shortening the time it takes to complete a tax ruling relating to changing ownership structure," Eran Yaakov, director of the Israel Tax Authority, said in the news release.

## Still Not Enough?

The new procedure will increase transparency and certainty in an area that previously was decided in private rulings, creating a more level playing field for taxpayers and investors, said Daniel Paserman, partner and head of tax at Gornitzky and Co. law firm in Tel Aviv. But he was skeptical about whether the caveat-riddled paperwork would attract many applicants.

"The form has a lot of declarations and a very long list of conditions and restrictions and provisions that are intended to make sure that Israel collects full taxes," Paserman said in an Oct.

3 interview. “They have even increased the restrictions” compared with previous rulings, and the form must be signed by a lawyer or adviser, which creates increased responsibility for practitioners, he said.

“If you have a big company going for a reorganization, you’ll still want a ruling,” he said. “Perhaps a small startup will not go for a ruling because for them it’s very costly, so they’ll go for the Green Route. But the Green Route itself is very cumbersome, it’s very lengthy with a lot of restrictions. It’s not such a big thing.”

Compared to the advantages U.S. taxpayers now enjoy following Trump’s reforms, they will still prefer to invest via a U.S. holding company, and the Green Route is unlikely to deter Israeli startups from incorporating abroad, said Gil Raveh, founding partner at Raveh Haber and Co. Advocates in Ramat Gan.

The tax authority “still did not understand the magnitude of the change of the Trump reform,” Raveh said by email Oct. 3.

“Nice try but not enough,” he said. “The problem is that the ITA requires that the IP will remain in Israel. This therefore only tells people that if in the future they would want to create a foreign holding company they could do it tax free—well, not really tax free because there are conditions and limitations.”

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