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Third Time's a Charm? Removing Barriers in the High-Tech Market

On July 2, 2020, an initial draft of the economic plan for the year 2020 was published. The economic plan incorporates changes that the government intends to promote regarding various sectors, predominantly the high-tech sector. One of the suggested reforms aims to promote the growth of the high-tech industry and the technological leadership of the State of Israel by removing funding barriers and encouraging the growth of Israeli companies whose intangible assets are in Israel and whose center of activity is located in Israel (the "**New Proposal**").

A substantial part of the New Proposal aims at amending the "Angels Law", originally enacted in 2011 as temporary provisions for a five year period. The initial purpose of the Angels Law was to encourage investments in Israeli high-tech companies during the initial stages of their activities by; (i) allowing individuals who invested in an Israeli high-tech company to deduct the investment as a tax expense over a three year period and up to NIS 5 million; and (ii) allowing corporations which purchased shares in an Israeli high-tech company to depreciate their investment over five years.

The Angels Law went through a major reform in 2016, as the original law was not considered attractive enough due to the uncertainty it caused investors with respect to their entitlement to its benefits, as the various conditions set to qualify for the benefit were post factum. For example, in order for an investment to be entitled to the tax benefit, at least 75% of the research and development expenditure of the company during the benefit period had to be incurred in Israel. Furthermore, among other conditions, the research and development expenditure had to be spent entirely on the promotion or development of the intellectual property owned by the company, throughout the benefit period. The reform made a few substantial changes and lightened the bureaucratic barriers, although some remained in force, such as receipt of a preliminary approval of the Israel Innovation Authority; an approval of a CPA for being compliant with the requirements of the law; and annual reporting to the Israel Innovation Authority. However, yet again the amended law was not attractive enough and only a few enjoyed its benefits. Therefore, it is now proposed to amend the law again, for the third time.

Below are some of the key changes proposed in the New Proposal, which if legislated, shall come into force in 2021 and will be valid for a four year period.

1. **Simplify the Bureaucratic Procedure under the Law** - According to the current Angels Law, in order for an Israeli high-tech company to qualify for the benefit allowing investments in its shares to be regarded as an expense, it must meet several conditions, obtain certain approvals and fulfil some reporting requirements. It is proposed to simplify the bureaucratic process, so that the required approvals and confirmations from the Innovation Authority and the company's accountants will no longer be required. Furthermore, it is also proposed to eliminate the requirement of the company's annual reporting to the Israel Innovation Authority.

2. **Deferral of Capital Gains Tax** - It is proposed to allow a deferral of capital gains tax generated from the sale of the investment in the high-tech company, provided that the investor made another investment in an early stage company within 12 months of the realization of the first investment. In such a case, the tax payment shall be postponed untilthe realization of the new investment.

3. **Cancel the Requirement to Maintain the Purchaser and the Target as Two Separate Entities** - It is proposed to cancel the requirement that both companies preserve their business activity as two separate entities, and allow for their merger.

4. **Benefit for Acquiring a Foreign Company** - It is proposed to extend the tax benefits also to the acquisition of foreign high-tech companies, provided that the intellectual property of the purchased target shall be transferred to Israel. The acquiring company is required to meet certain conditions, including having a minimum income of USD 25 million per year on average, during the three years prior to the acquisition, and that the transaction is for an amount of no less than USD 20 million.

It is worthwhile to note another tax relief presented in the New Proposal, which is intended to make available to high-tech companies credit required for their growth, to exempt interest on loans granted by a foreign financial institution to companies that meet certain conditions. The purpose of this exemption is to reduce the cost of obtaining financing by Israeli high-tech companies.

It should be emphasized that at this current stage it is only a draft of the government's proposal, and there is still a long way until the proposed changes will be adopted.

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