



## Insight #6: Certain Transaction-Related Tax Matters

**Choosing the Appropriate Purchaser.** Large multinational groups often have more than one possible candidate to invest in or acquire shares of an Israeli company. Consider tax consequences when choosing the purchasing entity within the group. Israel has entered into dozens of tax treaties that impose varying withholding tax rates on payments such as dividends, interest and capital gains. For example, as a general rule, treaties with European countries may impose lower withholding tax rates compared to Israel's treaty with the US.

- Note: make sure there is a clear business justification for your choice – treaty shopping is not tolerated by the Israel Tax Authority.

**Tax Withholding Requirements.** Israel imposes tax withholding obligations on purchasers of existing shares of Israeli companies. These obligations are often satisfied through appointment of a paying agent and transferring the consideration for the purchased shares, as well as the withholding duties, to the paying agent. In many cases the paying agent can also be the escrow agent for funds securing representations and warranties and the trustee holding shares or options in trust for Israeli resident grantees under the company's award plan, ensuring efficiency and ease of process. If you are not registered in Israel for withholding tax purposes, using a paying agent may not only be your preferred option – but your only option. Note that certain conditions need to be met for the withholding obligations to be effectively assumed by the paying agent and lifted from you as purchaser. Make sure they are included in all relevant transaction documents.

**Tax-Efficient Funding of the Transaction.** When determining the funding structure of the transaction, consider tax consequences applicable to repatriation of funds. Repatriation through dividend distributions will mostly likely be subject to withholding tax in Israel. Shareholder loans can be repaid with no tax but must carry interest that will most likely be subject to withholding tax in Israel. Note that Israeli tax law recognizes "capital notes" – unsecured, subordinated, non-interest-bearing shareholder loans for a period of at least 5

years. Capital notes are treated as capital for certain tax purposes however may be repaid as loans without the complications related to charging and paying interest. A combination of these mechanisms can lead to a more tax efficient funding of the transaction.

**Consider Favorable Israeli Tax Benefits.** The State of Israel encourages investments in Israeli companies by non-Israeli investors through beneficial tax treatment, most notably an exemption from Israeli capital gain tax which would have otherwise been imposed on gains derived from selling shares of Israeli companies. Other beneficial tax regimes may encourage investments in specific industries such as the high tech industry. Obtain Israeli tax advice and take it into consideration when structuring your transaction in order to ensure a favorable tax result.

**Value Added Tax.** Israel has a value added tax (VAT) regime which may apply to certain payments made by an Israeli resident to a non-Israeli resident. The current VAT rate is 17%, and unless you are registered in Israel for VAT purposes, this is an additional out of pocket expense which cannot be offset or deducted. Take VAT into consideration when structuring your investment or acquisition and seek ways to limit your VAT exposure.

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